No. 13111

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

IDALIA O. FRATT,
Appellant,

vs.

JOHN R. ROBINSON *and*
JANE DOE ROBINSON,
Husband and wife, et al,
Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

BRIEF OF APPELLEES

O. D. ANDERSON and J. P. HUNTER,
302-4 First National Bank Bldg.,
Everett, Washington,
Attorneys for All Appellees, Except W. E. Difford.

ALFRED J. SCHWEPPE
and M. A. MARQUIS,
657 Colman Bldg.,
Seattle, Washington,
Attorneys for Appellee, W. E. Difford.

No. 13111

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

IDALIA O. FRATT,
Appellant,

vs.

JOHN R. ROBINSON *and*
JANE DOE ROBINSON,
Husband and wife, et al,
Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WASHINGTON,
NORTHERN DIVISION

BRIEF OF APPELLEES

O. D. ANDERSON and J. P. HUNTER,
302-4 First National Bank Bldg.,
Everett, Washington,
Attorneys for All Appellees,
Except W. E. Difford.

ALFRED J. SCHWEPPE
and M. A. MARQUIS,
657 Colman Bldg.,
Seattle, Washington,
Attorneys for Appellee,
W. E. Difford.

INDEX

Page

JURISDICTIONAL STATEMENT 1

STATEMENT OF THE CASE 2

1. Pleadings Below 2

2. The Order Below 3

3. Questions Involved 3

SUMMARY OF ARGUMENT 4

ARGUMENT 4

1. The Securities and Exchange Act of 1934 Applies Only to Securities That Have Been Traded on a Securities Exchange or in an Over-the-Counter Market 4

(a) Analysis of the Act 4

(b) Intent of Congress as Expressed in Debate of the Bill 12

(c) The Term "OVER-THE-COUNTER" Markets, defined 15

(d) The Act is a Criminal Statute, Must be Strictly Construed 17

(e) Limited Application of the Term "Any Security Not So Registered" 19

(f) Answer in Answer to Appellant *Difford* and *Trans-America* cases discussed 22

(g) Limited Jurisdiction of Federal Courts 53

2. Section 10 (b) of The Act Does Not Provide a Civil Right of Action 54

3. Use Of The Mails Not Alleged to Bring Action Within Section 10 (b) of the Act 58

4. The Action Is Barred by the Statute of Limitations 60

CONCLUSION 63

TABLE OF CASES

Page

Acker v. Schulte, (D.C.S.D.N.Y.), 74 F. Supp. 683 61

Aluminum Co. of America v. United States, 123 F. 2d 615, (3rd Cir. 1941) 27

In re Barrett and Co., 9 SEC 319, 328 (1941) 16

Bowe v. Judson C. Burns, Inc., 137 F. 2d 37, 38 (3d Cir 1943) 28

Carter v. Liquid Carbonic Pacific Corporation, Ltd., (9 C.A.), 97 F. 2d 1 (1938) 21

Clark v. Paul Gray, Inc., 306 U.S. 583, 59 S. Ct. 744, L. Ed. 1001 (1939) 54

Commissioner of Internal Revenue v. Estate of Church, 335 U.S. 632 (1948) 38

Dahlberg v. Pittsburgh & L.E.R. Co., 138 F. 2d, 121, 122 (3d Cir. 1943) 28

Department of Labor, etc. v. Unemployment Comp. Board, 148 Pa. Super. 246, 24 A. 2d 667 (1942) 30, 31

Douglas County v. Grant County, 98 Wash. 355, 167 Pac. 928 62

Doyle v. Milton, 73 F. Supp. 281, (S.D.N.Y. 1947) 30, 31

Federal Power Commission v. East Ohio Gas Co., 338 U.S. 464, 468-469, 471 (1949) 30

Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 610 (1944) 28, 30

Federal Power Commission v. Panhandle Eastern Pipeline Co., 337 U.S. 498, 69 S. Ct. 1251 (1949) 25, 28

Federal Trade Commission v. Bunte Bros., 85 L. Ed. 881, 884, 61 S. Ct. 580, 312 U. S. 349 26

Fischman v. Raytheon Mfg. Co., 188 F. (2d) 783 55

Frye v. Schumaker, (D.C.E.D. Pa.), 83 F. Supp. 476, 478 61

Grossman v. Young, 70 F. Supp. 970, 972 (E.D. Wis. 1947) 30, 31

Hall v. American Cone and Pretzel Co., (D.C. E.D. Pa.), 71 F. Supp. 266, 269 61

Hanford v. Davies, 163 U.S. 273, 279, 16 S. Ct. 1051, 41 L. Ed. 157 (1896) 53

TABLE OF CASES—*Continued*

Page

Harrison v. Northern Trust Co., 317 U.S. 476, 479 (1943)..... 38
Hawkins v. Merrill, Lynch, Pierce, Fenner & Beane,
85, F. Supp. 104, 121 (W.D. Ark., Ft. Smith Div. 1949)..... 29
Heitfeld v. Benevolent and Protective Order of Keglers,
136 Wash. Dec. 637, 220 P. (2d) 655..... 62
Hellmich v.Hellman, 276 U.S. 233 (1928)..... 27
Illinois Natural Gas Co. v. Central Illinois Public Service Co.,
314 U.S. 498 (1942).....30, 31
Kardon v. National Gypsum Co., 69 F. Supp. 512 (1946)..... 55
Kemper v. Lohnes, (CCA 7 1949) 173 F. (2d) 44..... 58
KVOS v. Associated Press, 299 U.S. 269, 57 S. Ct. 197,
81 L. Ed. 183 (1936)..... 54
Lassiter v. Guy F. Atkinson Company, (9 Cir.), 162 F. (2d) 774.... 62
McNutt v. General Motors Accept. Corp.,
298, U.S. 178, 56 S. Ct. 780, 80 L. Ed. 1135 (1936)..... 54
Metcalf v. Watertown, 128 U. S. 586, 9 S. Ct. 173,
32 L. Ed. 543 (1888)..... 53
Nobel v. Martin, 191 Wash. 39, 70 Pac. (2d) 1064..... 62
North American Company v. Securities & Exchange Commis-
sion, 327 U.S. 686, 701-702, 703, 704 (1946).....30, 31
Norton v. Sarney, 266 U.S. 511, 515, 45 S. Ct. 145, 69
L. Ed. 413 (1925)..... 54
Norwegian Nitrogen Produce Co. v. United States,
288 U.S. 294, 315, 77 L. Ed. 796, 807, 53 S. Ct. 350..... 26
Osborne v. Mallory, (D.C. S.D. N.Y.), 86 F. Supp.
869, 879 .....55, 60, 61
Pa. Company for Insurances, etc. v. Dackert,
(3 Cir.) 123 F. (2d) 979, 985..... 61
Prussian v. U.S., 282 U.S. 675, 51 S. Ct. 223, 75 L. Ed. 610 (1931).. 18
Robinson v. Difford, 92 F. Supp. 145
(E.D. Pa. 1950) 17, 22, 24, 27, 29, 36

TABLE OF CASES—*Continued*

Page

Robinson v. Lewis County, 141 Wash. 642, Pac. 143, 256 Pac. 503 62

Rorick v. Board of Commissioners, 307, U.S. 208 59 S. Ct. 808, 83 L. Ed. 1242 (1939) 54

Rosenberg v. Hano, 121 F. 2d 818 (3d. Cir. 1941) 61

Schillner et al v. H. Vaughan Clarke & Co., (C.C.A. 2) 134 F. (2d) 875 59

Securities and Exchange Commission v. Torr, 15 F. Supp. 315, 319-320 (S.D. N.Y. 1936) 30, 31

Slavin v. Germantown Fire Ins. Co. (3rd Cir.) 174 F. (2d) 799 ..... 55, 60

Smith v. McCullough, 270 U.S. 456, 46 S. Ct. 338, 70 L. Ed. 682 (1926) 53

Smolowe v. Delendo Corporation, (2 Cir.) 136 F. 2d 231, 235 (1943) 30, 31

Southland Gasoline Co. v. Bayley, 319 U.S. 44, 47, (1943) 28

Speed v. Trans-America Corp., (D.C. Del.) 99 F. Supp. 808 (1951) 23, 24, 42, 43

Thomas v. Ritcher, 88 Wash. 451, 153 Pac. 333 62

Todd v. U.S., 158 U.S. 278, 15 S. Ct. 889, 39 L. Ed. 982 (1895) 18

United States v. American Truckers Association, Inc., 310 U. S. 534, 543-544 (1940) 37

United States v. CIO, 335 U.S. 106, 68 S. Ct. 1349, 92 L. Ed. 1849 (1948) 12

United States v. Corrick, 298 U.S. 435, 440, 56 S. Ct. 829, 80 L. Ed. 1263 (1936) 54

United States v. Dickerson, 310 U. S. 554, 561-562 (1940) 38

United States v. Dotterweich, 320 U. S. 277, 280 (1943) 28

United States v. Fruit Growers Express Co., 279 U. S. 363, 49 S. Ct. 374; 73 L. Ed. 739 (1929) 18

United States v. Griffin, 303 U.S. 226, 58 S. Ct., 601, 82 L. Ed. 764 (1938) 54

TABLE OF CASES—*Continued*

Page

United States v. Harris, 177 U.S. 305, 20 S. Ct. 609, 44 L. Ed. 780 (1900) 18

United States v. Jin Fuey Moy, 241 U.S. 394, 36 S. Ct. 658, 60 L. Ed. 1061 (1916) 19

United States v. Katz, 271 U.S. 354, 46 S. Ct. 513, 70 L. Ed. 986 (1926) 19

United States v. Monia, 317 U.S. 424, 431 (1943) 37

United States v. Wiltberger, 34 U.S. 73, 5 Wheaton 76, 1820) 18

United States v. Wittek, 337 U.S. 346, 352, 354 (1949) 30

Wright v. Securities and Exchange Commission, 112 F. 2d 89, (1940) 18, 28

STATUTES AND RULES

Page

Securities and Exchange Act of 1934
Sec. 2 (15 U.S.C.A. 78b) 8, 10, 12, 20, 30, 40, 43
Sec. 3 (10) (15 U.S.C.A. 78c) 22
Sec. 8 (15 U.S.C.A. 78h) 20
Sec. 9 (15 U.S.C.A. 78i) 20, 56, 57
Sec. 10 (15 U.S.C.A. 78) 5, 6, 27, 57
Sec. 10 (b) (15 U.S.C.A. 78j) 5, 6, 12, 18, 19, 21, 27, 30, 40, 54, 58
Sec. 12 (15 U.S.C.A. 781) 20, 59
Sec. 13 (15 U.S.C.A. 78m) 20
Sec. 15 (15 U.S.C.A. 78o) 11, 20, 21, 46, 47, 49
Sec. 16 (15 U.S.C.A. 78p) 20, 56
Sec. 18 (15 U.S.C.A. 78r) 56
Sec. 21 (15 U.S.C.A. 78u) 57
Sec. 29 (15 U.S.C.A. 78cc (b) 56
Sec. 32 (15 U.S.C.A. 78ff) 17, 57
S. E. C. Rule X-10b-5 ..... 5, 26

TEXTS

Page

Bearle & Means, *The Modern Corporation and Private Property* (1933) 15

Edward F. Cashion, *Fraud on Seller of Securities*, proceedings of 27th Annual Convention of National Association of Securities Commissioners (1944) 7, 50

Dice, *The Stock Market*, (1941) 15

Harvard Law Review, Vol. 61, p. 858 22

Harvard Law Review, Vol. 64, p. 1018 ..... 23, 25

Harvard Law Review, Vol. 59, p. 769, 779 56

John C. Loeser, *The Over-The-Counter Securities Market—What It Is and How It Operates*, (1940) 15

Louis Loss, Cases and Materials on SEC Aspect of Corporate Finance 15, 52

Charles H. Meyer, *The Securities Exchange Act of 1934, Analysed and Explained* 15

Prime, *Investment Analysis*, (1946) 15

Securities Exchange Commission, 14th Annual Report (1948) p. 24 ..... 7, 51

Security Market (1935, pub. 20th Century Fund Inc., N. Y. 15

Sutherland, *Statutory Construction*, Vol. 2, Sec. 4820 (3d Ed. 1943) 30

LEGISATIVE MATERIALS

Cong. Rec. of 4-30-34, 73d Cong., Sec. Sess., Vol. 78, No. 94, p. 7419 14

78 Cong. Rec., 7701 13

78 Con. Rec., p. 8190 14

78 Cong. Rec., 7868 66

78 Cong. Rec., 7711 67

78 Cong. Rec., 8189 ..... 47, 67, 68

House Rep. No. 1383 65

House Rep. No. 1383, p. 15, 16, 73d Cong., 2d Sess. 11, 65

House Rep. No. 1383, p. 15 65

Senate Rep. No. 792, p. 6, 73d Cong., 2d Sess. 65

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

IDALIA O. FRATT, a widow,

Appellant,

vs.

JOHN R. ROBINSON and JANE DOE ROBINSON, husband and wife; TED R. ROBINSON and JANE DOE ROBINSON, husband and wife; LAURA R. McLEOD and JOHN DOE McLEOD, wife and husband; J. S. ROBINSON, and JANE DOE ROBINSON, husband and wife; and A. W. V. FORD and JANE DOE FORD, husband and wife, individually and as Officers and Directors of Robinson Plywood and Timber Company, a corporation; W. E. DIFFORD and JANE DOE DIFFORD, husband and wife; and SAMUEL P. McGHIE and JANE DOE McGHIE, husband and wife, individually and as agents for the aforementioned defendants, and as agents for the Robinson Plywood and Timber Company; and the ROBINSON PLYWOOD & TIMBER COMPANY, a corporation (formerly known as the Robinson Manufacturing Company),

Appellees.

JURISDICTIONAL STATEMENT

Appellees contend that the District Court did not have jurisdiction and properly dismissed the action but concur that this Court has jurisdiction to review the Order of Dismissal.

STATEMENT OF THE CASE

1. Pleadings Below

In the court below appellees moved to dismiss the complaint under Rule 12 (b) (1) for lack of jurisdiction over the subject matter it ,appearing on the face of the complaint that there is no diversity of citizenship and that the action does not involve a controversy under the constitution or laws of the United States in that:

(a) The transactions complained of did not involve a security that was ever traded in or upon a Securities Exchange or upon an "over-the-counter" market and are, therefore, not within the purview of the Securities and Exchange Act of 1934, which is set forth in the complaint as the basis of jurisdiction. (Tr. 25-35)

(b) The Securities Exchange Act of 1934 does not provide a civil right of action for the type of transactions alleged in the complaint. (Tr. 25-35)

and further moved to dismiss the complaint under Rule 12 (b) (6), on the ground that

(c) There is no allegation that defendants or any of them made use of any means or instrumentality of Interstate Commerce or of the mails or of any facility of any National Securities Exchange in connection with the use or employment of any manipulative or deceptive device in the acquisition of appellants' stock in contravention of Section 10 of the Securities Exchange Act or any rules and regulations of

the Securities and Exchange Commission adopted pursuant thereto. Tr. 25-35)

(d) That the action was not commenced within the time limited by law. (Tr. 25-35)

2. The Order Below

By order dated August 16, 1951, the District Court granted appellees' motion to dismiss solely upon ground (a) above and denied appellees' other motions. (Tr. 38)

3. Questions Involved

1. Does the Securities Exchange Act of 1934 apply to an isolated sale of stock where said stock was never registered on a securities exchange and never sold in an "over-the-counter" market?

2. Does the Securities Exchange Act of 1934 provide a civil right of action for the type of transactions alleged in the complaint?

3. Does the complaint allege the use of any means or instrumentality of Interstate Commerce or of the mails or of any facility of any National Securities Exchange in connection with the use or employment of any manipulative or deceptive device in the acquisition of plaintiff's stock in contravention of said Section of the Act or of any rules and regulations of the Securities and Exchange Commission adopted pursuant thereto?

4. Was the action commenced within the time limited by law?

SUMMARY OF ARGUMENT

It is appellees' position that the Securities and Exchange Act of 1934 (15 U.S.C.A., 78a, *et seq.*) does not apply to isolated, door-step sales of stock never registered on any securities exchange and never sold in any "over-the-counter" market and for which there is no market; that section 10 of the Act does not provide a civil right of action but that it is purely a criminal statute; that the complaint does not allege the use of any means or instrumentality of Interstate Commerce or of the mails or any facility of any national securities exchange in connection with the transactions complained of, as required by the Act, and that the action was not commenced within the time limited by law inasmuch as under applicable local law of the State of Washington the period of limitation is two years (not three).

ARGUMENT

1. The Securities Exchange Act of 1934 Applies Only to Securities that Have Been Traded on a Securities Exchange or on an "Over-the-Counter" Market.

(a) Analysis of the Act.

No appellate court has, to our knowledge, decided the question which we now discuss.

There is no averment in the complaint that any of

the stock of the company was or is now listed on a National Exchange or that it was ever traded at any time in an "over-the-counter" market as the latter term was intended by Congress.

The complaint has solely grounded this cause of action on the Securities Exchange Act of 1934 (78 U.S.C.A. 78a, *et seq.*) and, more particularly, Section 10 (b) thereof (15 U.S.C.A. 78j (b)) and Rule X-10b-5 promulgated thereunder by the Securities and Exchange Commission, which statute and rule are set forth below:

> "Section 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."
>
> "*Rule* X-10B-5: It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange:
>
> (1) To employ any device, scheme, or artifice to defraud,

(2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

Appellees contend that the Act does not and was not intended by Congress to cover transactions in a security unless that security at some time in its history was traded on a National Securities Exchange or in an "over-the-counter" market. In other words, that the term "any security not so registered" as used in Section 10 (b) of the Act refers to securities that have been sold in "over-the-counter" markets and is not a blanket term meaning "all securities." It will be shown that the "over-the-counter" market, as used in the Act, refers to specific types of transactions and is not, as said before, a "catch all" term covering all securities and transactions not conducted through the medium of a National Exchange.

To take jurisdiction of this matter the court must expressly find that the Act (not Rule X-10b-5) applies to all transactions involving the purchase or sale of any security anywhere in the United States regardless of whether such security was dealt with on a National Securities Exchange or upon an "over-

the-counter" market, or whether there was any market whatsoever, so long as the mails or an instrumentality of Interstate Commerce is used. It is submitted that such an interpretation goes far beyond the avowed scope and purpose of the Act.

The general purpose of the Securities Exchange Act of 1934 was set forth by Edward H. Cashion, Counsel to the Corporation Finance Division, Securities and Exchange Commission, in his address "Fraud on the Seller of Securities" before the National Association of State Securities Commissioners, St. Louis, Mo., on December 13, 1944 (mimeographed address on file with S.E.C.) as follows:

> "The Securities Exchange Act of 1934 and its subsequent amendments were designed *to regulate trading in securities*—the purchase and sale of securities—*on national securities exchanges and in over-the-counter markets*, and to regulate brokers and dealers. The act and its amendments were designed to strengthen the fraud prevention and disclosure provisions of the prior act." (Emphasis supplied).

A similar statement of its general purpose appears in the 14th Annual Report, Securities and Exchange Commission, 1948, at page 24:

> "The Securities Exchange Act of 1934 is designed to eliminate fraud, manipulation, and other abuses in the *trading of securities both on the organized exchanges and in the over-the-counter markets, which together constitute the Nation's facilities for trading in securities;* to

make available to the public information regarding the condition of corporations whose securities are listed on any national securities exchange; and to regulate the use of the Nation's credit in securities trading." (Emphasis supplied).

An examination of the format and context of the Act shows the plan used by Congress in carrying out this purpose.

Section 1 is the short title. Section 2 (15 U.S.C.A. 78b) sets forth in detail the purpose of the act and the evils it seeks to remedy. To interpret properly the subsequent provisions of the Act it is essential to have this section in mind especially since Congress itself was outlining the scope and purpose of the statute:

"*Necessity for Regulation*

For the reasons hereinafter enumerated *transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets* are affected with a national public interest which makes it necessary to provide for regulation and control of *such transactions* and practices and matters related thereto, including transactions by officers, directors, and principal security holders, to require appropriate reports, and to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance *of fair and honest markets in such transactions*:

(1) *Such transactions* (a) are carried on in large volume by the public generally and in large part originate outside the States in which the *exchanges and over-the-counter markets* are located and/or are effected by means of the mails and instrumentalities of interstate commerce; (b) constitute an important part of the current of interstate commerce; (c) involve in large part the securities of issuers engaged in interstate commerce; (d) involve the use of credit, directly affect the financing of trade, industry, and transportation in interstate commerce, and directly affect and influence the volume of interstate commerce; and affect the national credit.

(2) The prices established and offered in *such transactions* are generally disseminated and quoted throughout the United States and foreign countries and constitute a basis for determining and establishing the prices at which securities are bought and sold, the amount of certain taxes owing to the United States and to the several States by owners, buyers, and sellers of securities, and the value of collateral for bank loans.

(4) Frequently the prices of securities *on such exchanges and market* are susceptible to manipulation and control, and the dissemination of such prices gives rise to excessive speculation, resulting in sudden and unreasonable fluctuations in the prices of securities which (a) cause alternately unreasonable expansion and unreasonable contraction of the volume of credit available for trade, transportation, and industry in interstate commerce, (b) hinder the proper appraisal of value of securities and thus prevent a fair calculation of taxes owing to the United States and to the several States by owners, buy-

ers and sellers of securities, and (c) prevent the fair valuation of collateral for bank loans and/or obstruct the effective operation of the national banking system and Federal Reserve System.

(4) National emergencies, which produce widespread unemployment and the dislocation of trade, transportation, and industry, and which burden interstate commerce and adversely affect the general welfare, are precipitated, intensified, and prolonged by manipulation and sudden and unreasonable fluctuations of security prices and by excessive speculation *on such exchanges and markets*, and to meet such emergencies the Federal Government is put to such great expense as to burden the national credit. June 6, 1934, c.404, § 2, 48 Stat. 881." (Emphasis supplied).

If Congress had intended to regulate and control all transactions in securities, it could have said so in very simple language. For example, it could have said "all securities" or "all transactions." This it did not do. On the contrary, it specifically stated that it was necessary to regulate and control "transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets and practices and matters related thereto." Throughout Section 2 (15 U.S.C.A. 78b) the phrases "such transactions" and "such exchanges and markets" are used frequently. Not one expression of intent to regulate all securities transactions appears.

Appellees are not arguing that the Act does not apply to a transaction in a security unless the trans-

action itself took place on a National Exchange or an "over-the-counter" market. If a stock is or was listed on a National Exchange, transections in that stock which take place off the exchange might well affect the prices for transactions in that security on the exchange. The same is true of private transactions in a security which is commonly traded "over-the-counter." The remaining sections of the Act make it evident that Congress was primarily interested in controlling National Securities Exchanges. Approximately 12 Sections are devoted to this subject, while Section 15 (15 U.S.C. 78o) pertains exclusively to "over-the-counter" markets and are limited to controlling brokers and dealers in "over-the-counter" securities. As will be shown later, Congress decided that there had to be some regulation of these "over-the-counter" markets to make effective the primary regulation of National Securities Exchanges. That the regulation of National Securities Exchanges was the primary purpose of Congress was apparent from House Report Number 1383 wherein it was stated under the heading "The General Purpose of the Bill" as follows:

> "To reach the causes of the 'unnecessary, unwise and destructive speculation' condemned by the President's message, this bill seeks to regulate the stock exchanges and the relationship of the investing public to corporations which invite public investment by listing on such exchanges."

This brief resume of the Act itself clearly shows

that Congress intended to control National Securities Exchanges and members thereof and also, the securities traded on such exchanges and in the "over-the-counter" markets, and brokers and dealers whose facilities made up the "over-the-counter" markets. It is submitted that Section 10 (b) (15 U.S.C.A. 78j (b)) fits into this legislative scheme and controls fraudulent transactions with respect to securities that have been or now are registered on an exchange or have been or now are traded in "over-the-counter" markets, regardless of whether the exchange or the "over-the-counter" facilities are used in the specific transactions complained of. On the other hand, the appellant and *amicus curiae* contend that Section 10 (b) is a "catch all" provision which standing alone regulates and controls every individual transaction in every security. It is more than evident that such a construction is not supported by the Act itself and would be expanding its coverage beyond the expressed legislative intent.

(b) Intent of Congress as Expressed by Legislators in Debate of the Bill.

Since Section 2 of the Act is so positive and explicit in setting forth the congressional intent, it would seem that no question of construction is involved. However, if construction is needed, it will be demonstrated beyond any doubt that the Act applies

only to those transactions indicated by appellees. In determining the meaning of a statute or the extent of its coverage, the purpose of Congress is an all important factor. In *U. S. vs. C.I.O.*, 335 U. S. 106, 68 S. Ct. 1349, 92 L. Ed. 1849 (1948) it was said:

> "The purpose of Congress is a dominant factor in determining meaning. There is no better key to a difficult problem of statutory construction than the law from which the challenged statute emerged. Remedial laws are to be interpreted in the light of previous experience and prior enactments. Nor, where doubt exists, should we disregard informed congressional discussion."

Mr. Rayburn, when he was Chairman of the House Interstate and Foreign Commissioners Committee, which thoroughly considered the bill (H.R. 9323) in substantially its present form, stated:

> "The Commission also has power to regulate the over-the-counter markets, but in so doing *they can only regulate the brokers or dealers who create a public market for both the purchase and sale of such securities*, and cannot compel corpel corporations not interested in having a public market for their shares to file any statements or submit to any regulation." (78 Con. Rec. 7701). (Emphasis ours).

Again, Mr. Rayburn said:

> "In Section 3 of the Bill, we set forth the definitions; and I shall insert in the Record at this point some further definitions of terms which may be used in connection with the discussions of the bill. . . ."

"'Over-the-counter market' as used in this bill, refers to a market maintained off a regular exchange by one or more dealers or brokers. *The market must be maintained both for the purchase and sale of the securities in question.* A dealer or broker who merely undertakes a request to find a purchaser for a person who wants to sell or to find a seller for a person who wants to buy, would not usually be considered to be creating a market. *But the dealer who normally is willing to quote 'a market,' i. e., both the price at which he will buy and the price at which he will sell, is creating an over-the-counter market.*" (Cong. Record of 4-30-34, 73d Cong., 2 Sess., Vol. 78, No. 94, P. 7419). (Emphasis ours).

When the bill was debated on the Senate floor the following occurred between Senator C. C. Dill and Senator Alben Barkley:

"*Mr. Dill.* The Senator is a lawyer and he knows that lawyers can make words mean almost anything. If it is the intent of this bill not to include corporations whose stock is not so registered on an exchange or not dealt in over-the-counter, of course, if that is the intent, he, as a legislator, only has to write it in the bill so that there cannot be any question.

"*Mr. Barkley.* Section 2 of the bill itself says that only those are included in the proposed law. Why should any one imagine that someone else will be included in it?" (78 Cong. Recrd, p. 8190).

We are making exactly the same point in this brief as was made by Senator Barkley.

For additional statements by Legislators as to the intent of the bill during the course of its debate see Appendix "A" at page 64.

(c) The Term "Over-the-Counter" Market Has a Well-Defined Meaning and Does Not Include Every Stock Transaction.

The meaning of the term "over-the-counter" market was well stated by Mr. Rayburn, as above pointed out, and no exception was taken by legislators to it. In addition, it has been well defined by officials of the Securities and Exchange Commission, text writers, professors, bankers, brokers, and business men in the following texts: *The Stock Market,* (1941), Dice, Professor Business Organizations, Ohio State Univ.); *Investment Analysis,* (1946) Prime, (Professor of Finance, A. Y. Union); *The Over-the-Counter Securities Market—What It is and How It Operates,* (1940) John C. Loeser of National Quotations Bureau, Inc. *Pub.* National Quotations Bureau, Inc., N. Y.; *The Modern Corporation and Private Property,* (1933) Bearle and Means, *Pub.* The MacMillan Co., N. Y.; *The Security Market,* (1935) *Pub.* Twentieth Cent. Fund, Inc., N. Y.; The Securities Exchange Act of 1934, Analyzed and Explained, Charles H. Meyer, *Pub.* Francis Emory Fitch, Inc., Financial Publishers, N. Y.; *Cases and Materials on S.E.C. Aspects of Corporate Finance,* Lois Loss, Associate Gen. Counsel for S.E.C., Philadelphia, May, 1947.

Quotations from the above materials are set forth in Appendix "B" at page 68

From a reading of these definitions contained in the appendix it is apparent beyond doubt that "over-the-counter" markets do not have the broad meaning contended for by appellant. In order to have an "over-the-counter" market there must exist, as said by Mr. Rayburn, a market maintained *both for the purchase and sale of the securities in question.* If a security, as in the instant case, has never been traded in its history on such a market it unquestionably is not covered by the act. It is interesting to note, as shown by the contents of App. "B", that the Securities and Exchange Commission itself concurred with this point of view from 1934 to 1942.

Even more startling is that the Securities and Exchange Commission as late as 1941, in the case of *In the Matter of Barrett & Co.*, 9 S.E.C. 319, 329 (1941) definitely and positively expressed the view that an "over-the-counter" market is a market made by brokers, and dealers; a view absolutely contrary to its position as *amicus curiae* in the present case. For a full quotation from the *Barrett* case, *supra*, expressing the Commission's earlier view, see Appendix "B", page 76.

The appellant and the Securities and Exchange Commission, as *amicus curiae*, are now vigorously contending that the term "over-the-counter" market in-

cludes an isolated door-step sale of a security which has no "market." Even the case of *Robinson vs. Difford* (E.D. Pa. 1950) 92 F. Supp. 145, so strongly relied upon by appellant and *amicus curiae*, rejects their point of view in this regard. Indeed, Judge Grimm in the *Difford* case definitely recognized that an "over-the-counter" market is a particular type of market as contended for by appellees and as defined by the authorities above set forth. On page 148 of the *Difford* opinion in footnote 3, Judge Grimm defines an "over-the-counter" market as follows:

> "Securities traded in the over-the-counter market may be defined generally as those securities not registered on a National exchange *which are traded through a securities broker or with a securities dealer.*" (Emphasis ours)

Thus it will be noted that even in the case of *Robinson v. Difford, supra*, that the court rejected appellant's point of view that a "door-step" sale of stock constitutes a sale in the "over-the-counter" market because, as set forth above, an "over-the-counter" market only includes stocks that are "traded through a securities broker or with a securities dealer."

(d) This Act is a Criminal Statute and Must be Strictly Construed.

The Securities Exchange Act of 1934 is a criminal statute. Section 32 (15 U.S.C.A. 78ff) provides a $10,000.00 fine, two years imprisonment, or both, for

violation of the Act, or the Rules promulgated thereunder. Therefore, the Act, being criminal, must be strictly construed. In *Wright v. Securities and Exchange Commission*, 112 F. (2d) 89 (1940) the court said:

> "The statute (S.E.C Act of 1934) must be strictly construed since a violation of it may be punished as a crime."

One of the oldest cases on this subject is *United States v. Wiltberger*, 34 U. S. 73, 5 Wheat. 76, 95, (1820) wherein Chief Justice Marshall stated:

> "The rule that penal laws are to be construed strictly, is perhaps not much less old than construction itself."

Accord: *Todd v. U. S.*, 158 U. S. 278, 15 S. Ct. 889, 39 L. Ed. 982 (1895); *U. S. v. Harris*, 177 U. S. 305, 20 S. Ct., 609; 44 L. Ed. 780 (1900); *Prussian v. U. S.*, 282 U. S. 675, 51 S. Ct. 223; 75 L. Ed. 610 (1931) and *U. S. v. Fruit Growers Express Co.*, 279 U. S. 363, 49 S. Ct. 374; 73 L. Ed. 739 (1929).

Obviously, if there is a civil right of action under Section 10 (b) it only arises because of the commission of a crime. It is more than apparent, therefore, that Section 10 (b) cannot be more broadly construed for civil purposes than for criminal purposes. If the court holds otherwise it will be lifting its jurisdiction by its own bootstraps.

(e) Limited Application of the Words "Any Security Not So Registered."

Section 10 (b) (15 U.S.C.A. 78j) of the Act refers to transactions in "any security registered on a National Exchange or any security not so registered." Under well established rules of statutory construction this does not mean transactions in "any security" without limit, but must mean transactions in those securities specifically covered by the Act. In this case, the Act covers transactions in any security registered on a National Securities Exchange or dealt with in the "over-the-counter" market *and no more.*

In *United States v. Katz,* 271 U. S. 354, 46 S. Ct. 513, 70 L. Ed. 986 (1926) defendants were indicted under the National Prohibition Act which provided "no person shall manufacture, purchase for sale, sell or transport any liquor. . . ." The Court held, in viewing the statute as a whole that, the above quoted section only applied to persons authorized by the other Sections of the Act to deal in liquor under government permit and did not mean "all persons," without limitation. The Court cited *United States v. Jin Fuey Moy,* 241 U. S. 394, 36 S. Ct. 658, 60 L. Ed. 1061 (1916) wherein it was held:

> "This court held that the words 'any person' not registered could not be taken to apply to any person in the United States but must be read in harmony with the purposes of the act to refer to persons required by law to register." (P. 516)

Similarly, it is obvious that the words "any security not so registered" must be read in harmony with the purpose of the Securities and Exchange Act of 1934 and be construed to mean "any security traded on an 'over-the-counter' market." Otherwise this section clearly goes beyond the scope of the Act, as limited by Congress itself in Section 2 (78 U.S.C.A. 78b) of the Act quoted above.

In reviewing the various sections of the Securities and Exchange Act it will be noted that when Congress was dealing with situations applicable only to securities dealt with on an exchange, appropriate words indicating that intention were used; e.g. Sections 8, 9, 12, 13 and 16. (15 U.S.C.A., Section 78h, 78i, 78l, 78m, 78p). Nowhere in the Act is there a specific reference to a security trade in an "over-the-counter" market. It seems obvious that Congress, dealing with only two types of securities made the necessary distinction whenever it was required by specifically stating that the Act applied in such instances to a security registered on a National Securities Exchange.

When dealing with both types of securities, Congress, as in Section 10 (b) would merely refer to, first, a security registered on an exchange, and then to any "security not so registered."

Section 15 of the Act (15 U.S.C.A. 78-o) bears the heading "OVER THE COUNTER MARKETS." That heading, being a part of the Act as enacted by Con-

gress, should be considered in construing the statute. *Carter v. Liquid Carbonic Pacific Corporation, Ltd.*, (9th Cir.) 97 Fed. (2d) 1 (1938).

In Section 15, (U.S.C.A. 78-o) where Congress was specifically dealing with "over-the-counter" markets as shown by the heading not once did Congress mention the term. Rather, Congress simply referred to "over-the-counter" markets as securities "otherwise than on a National Securities Exchange." In view of the heading of the Section and the subject matter dealt with it is obvious that Congress by using the term "otherwise than on a National Securities Exchange" was limiting that term in its application to "over-the-counter" markets only.

It will thus be noted that when Congress was referring to a security dealt with on an "over-the-counter" market it merely used the words "any security" with the qualifying words "otherwise than on a National Security Exchange." It seems clear that since Congress, when deliberately defining a security dealt with in "over-the-counter" markets defined it in one place in the act as "any security otherwise than on a National Securities Exchange" that it meant precisely the same thing in Section 10 (b), otherwise it would have included after the words "or any security not so registered" in Section 10 (b), some language such as "including securities not traded in any over-the-counter market."

The fact that Congress has quite wisely, given a broad and all inclusive definition of the word "security" in Section 3 (10) (15 U.S.C.A. 78-c-10) does not refute our argument that the words "any security" had a limited application. This broad definition was made so that full control would be had over the National Exchanges and "over-the-counter" markets for *all types* of securities and had no reference to the markets they were traded in. Our position in this regard is further buttressed by an article appearing in 61 Harvard Law Review, 858, wherein it was said at page 866:

> "The determination of what persons and transactions are included may ultimately rest upon inquiry into the evils against which the act was directed. By this test, the introduction to the Securities Exchange Act would suggest that Congress did not intend to include all persons and all purchases and sales of securities. *It would limit application of the rule to 'transactions in securities as commonly conducted upon securities exchanges and over the counter market*, and 'practices and matters related thereto, including transactions by officers, directors, and principal security holders'." (Emphasis supplied)

(f) Argument In Answer to Appellant—Difford and Trans-America Cases Discussed.

Only three District Courts have directly passed on this subject. The first decided case was that of *Robinson v. Difford*, (E. D. Pa.) 92 F. Supp. 145 (1950),

wherein Judge Grimm found adversely to appellants' position here. The second District Court decision was that of United States District Judge J. Frank McLaughlin of Honolulu, sitting by assignment in the United States District Court for the Western District of Washington, in the instant case, who, without rendering a written opinion, refused to follow Judge Grimm's opinion in the *Difford case.* The third case is that of *Speed v. Trans-America Corp.*, (D. C. Del.) 99 F. Supp. 808, decided August 8, 1951, wherein Judge Leahy, without the benefit of a reported opinion from Judge McLaughlin, followed the holding in the Difford case.

The cases cited by appellant as purportedly being decisive of this question are, upon examination, not in point, as the question was never raised or discussed. Without discussing appellant's cases suffice it to say that the court in *Speed v. Tran-America, supra,* at page 831 of the opinion said:

> "Judge Grimm has been the first to consider specifically the question whether Section 10 (b) and Rule X-10b-5 apply to transactions in securities not traded on an exchange or in the over-the-counter market."

In an article appearing in 64 Harvard Law Review, 1018 wherein the case of *Robinson v. Difford, supra,* was discussed, the article specifically states:

> "This (Difford case) is the first explicit ju-

> dicial determination that the fraud provisions of Section 10 (b) may be invoked even though the unregistered securities were not of an issue regularly traded."

Consequently, appellees reach this court with two District Court Decisions against them, one District Court decision in their favor, and no decision by any Appellate Court. For these reasons we discuss the two cases adverse to our contention.

It must be noted that the opinion in *Speed v. Trans-America Corp.*, (D. C. Del.) 99 F. Supp. 808, consists of 41 pages involving many questions but that only approximately one page is devoted to the subject at hand. Indeed, it appears that the court in *Speed v. Trans-America*, not having the benefit of Judge McLaughlin's opinion in this case and confronted with many other legal questions in the case, simply followed the conclusions reached by Judge Grimm in the *Difford* case. For this reason our criticism of *Robinson v. Difford* applies equally well to *Speed v. Trans-America.*

At the outset, the decision in *Robinson v. Difford, supra*, is strongly questioned in a recent article appearing in 64 Harvard Law Review 1018, written prior to the decision in *Speed v. Trans-America.* This article comprises an impartial and scholarly analysis of Judge Grimm's opinion in the *Difford* case and because we believe that it will be of great aid and assistance to this

court in correctly determining the question we have set forth the entire contents of the article in Appendix "C" at page 79. However, the following portion of the article is pertinent here:

> "Since isolated transactions in securities of closely held corporations do not seem to be affected with a substantial national public interest, at least as determined by Congress in Section 2, it appears unlikely that Congress intended the statute to be applicable to dealings of this character, especially in view of the substantial criminal liabilities imposed for violation of the Act. And whatever doubt may remain concerning the intended scope of the Act should not necessarily be resolved in favor of the S.E.C's interpretation in Rule X-10B-5, since the eight-year delay before promulgation may be an indication of the Commission's doubt as to the validity of its interpretation." Cf. *FPC v. Panhandle Eastern Pipe Line Co.*, 337 U. S. 408 (1949).

Indeed, the history of the Security Exchange Commission's actions with respect to the Rules under Section 10 (b) indicates that even the commission itself did not believe that it had the broad power it now, as *amicus curiae*, contends for. In construing the scope and meaning of Section 10 (b) of the act one cannot overlook the fact that eight years elapsed before the Security Exchange Commission promulgated Rule X-10b-5, which was released on May 21, 1942. In this respect the language of the Supreme Court in *Federal Power Commission v. Panhandle Eastern Pipe Line*

Co., 337 U. S. 498, 513, 69 S. Ct. 1251 (1949) is in point. The court said:

> "*Thus for over ten years the Commission has never claimed the right to regulate the dealings in gas acreage. Failure to use such an important Power for so long a time indicates to us that the Commission did not believe the power existed.* In the light of that history we should not by an extravagant, even if abstractly possible, mode of interpretation push powers granted over transportation and rates so as to include production. If possible all Sections of the Act must be reconciled so as to produce a symmetrical whole. *We cannot attribute to Congress the intent to grant such far-reaching powers as implicit in the Act when that body has endeavored to be precise and explicit in defining the limits to the exercise of Federal power.*" (Emphasis ours)

Accord: *Federal Trade Commission v. Bunte Bros.*, 312 U. S., 349, 85 L. Ed. 881, 884, 61 S. Ct. 580; *Norwegian Nitrogen Produce Co. v. United States*, 288 U. S., 294, 315, 77 L. Ed. 796, 807, 53 S. Ct. 350.

It is inconceivable that a "loop-hole" could have existed for eight years without remedial action of any kind by the Commission, if the Commission believed that it had authority to block the "loop-hole" by the adoption of Rule X-10b-5 in 1942.

We think that the court in the case of *Robinson v. Difford*, arrived at a wrong result and that it was reached through entirely erroneous reasoning and in

complete disregard of well established rules relating to statutory construction.

The court simply disposes of the argument that the Act does not cover transactions in securities neither registered on an exchange nor traded in an "over-the-counter" market by quoting from Section 10 of the Act these words, "any security not so registered" and then in complete disregard of the contents of Section 2 of the Act comes to the startling conclusion that the language of Section 10 (b) is clear and no other interpretation is possible. The court says on page 148 of the *Difford opinion*:

> "Without deciding that these statements do show such a limited purpose as is contended by defendants, this court must refuse defendants' contention, because Section 10 (b) itself, under which the present action was brought, is unambiguous."

The foregoing statement is not only contrary to the opinion of Judge McLaughlin in the court below but is also contrary to the well established rule that a statute or an act must be construed as a whole. One section cannot be isolated and read alone.

In *Hellmich v. Hellman*, 276 U. S. 233, 236-237, 72 L. Ed. 544, 546-547 (1927) is was held that in construing the meaning of the word "dividend" that §201 (a) could not be isolated and read alone must be read with § 201 (c) as a whole. To the same effect is *Aluminum Co. of America v. U. S.*, 123 F. (2d) 615, 618-619

(3rd Cir. 1941) where it was said, "and a court will adopt that construction which gives effect to all parts of a statute to the end that the manifest purpose of Congress will not be obstructed." *Bowe v. Judson C. Burns, Inc.*, 137 F. (2d) 37 (3d. Cir. 1943) held that, "legislative intent must be drawn from the (Fair Labor Standards) Act as a whole." In *Dahlberg v. Pittsburg, & L. E. R. Co.*, 138 F. (2d) 121, 122 (3d Cir. 1943) it was held in construing a statute that, "words may not be taken out of their context and endowed with an absolute quality, nor may the plan of the entire statute be disregarded." *Southland Gasoline Co. v. Bayley*, 319 U. S. 44, 47, 87 L. Ed. 1245, 1248 (1942) in construing the Fair Labor Standards Act held that both sections of an important general statute must be read together. In interpreting the Federal Food and Cosmetics Act it was held that, "the guaranty clause cannot be read in isolation." *U. S. v. Dotterweich*, 320 U. S. 277, 180, 288, L. Ed. 48, 55 (1943). In *Federal Power Comm. v. Panhandle Eastern Pipe Line Co.*, 337 U. S. 498, 514, 93 L. Ed. 1499, 1509 (1948) it was said that "If possible, all sections of the (Natural Gas) Act must be reconciled so as to produce a symmetrical whole."

This general rule, to which we know of no exception, has likewise been applied to the Securities and Exchange Act of 1934. In *Wright v. Securities and Exchange Commission*, (2d Cir. 1940) 112 F. (2d) 89, it

was held that, "Under the most elementary principles of statutory construction section 27 must be so interpreted, if possible, as to be consistent with other provisions of the statute." The court in *Hawkins v. Merrill, Lynch, etc.*, (W. D. Ark., Ft. Smith Div. 1949) 85 F. Supp. 104, 121, said:

> "The provisions of the Securities and Exchange Act of 1934, and the regulations promulgated thereunder, should be interpreted in the light of the evils to be prevented by the enactment of that legislation."

The Court, in *Robinson v. Difford*, committed, in our opinion, another fundamental error when on page 148 of the opinion it said:

> "There are no other sections of the Act which indicate that Congress intended to limit the application of the act to the transactions involving either registered securities or unregistered securities traded in the over-the-counter market."

The above sentence in itself is not plain, but the court must have meant "no other sections" than Section 2. If, as the court said, resort need only to be made to Section 10 (b) itself, then of course, the sentence above quoted is superfluous because the court would not be concerned with other sections of the Act.

The court in the *Difford* case on page 148 of the opinion further said:

> "Reliance on the preamble statement of Section

> 2 in order to alter the plain and unambiguous provisions of Section 10 (b) would violate a basic canon of statutory construction, that statements in a preamble may be referred to only for the purpose of clarifying an ambiguity in a statutory provision."

The only way the court could find Section 10 (b) unambiguous was to refuse to read the entire Act as a whole, which refusal violates, as already pointed out, an elementary principle of statutory construction. When the entire Act is read as a whole the ambiguity of Section 10 (b) is most apparent. The ambiguity was apparent to Judge McLaughlin in the court below.

In the second place, Section 2 is not a preamble, but is a so-called "policy section." Sutherland Statutory Construction, Vol. 2, Section 4820 (3d Ed. 1943) states the rule as follows:

> "In place of a preamble it has become common, particularly in Federal legislation, to include a policy section which states the general objectives of the act in order that administrators and courts may know its purposes. This is frequently of significance where the enforcement of the act depends principally upon administration and the administrative officers have not participated in the preparation of the legislation."

Illustrative of this rule is *Department of Labor, etc. v. Unemployment Comp. Board*, (Pa.) 24 A. (2d), 667 (1942).

> "Section 3 of Article I (Preliminary Provisions)

> of the Unemployment Compensation Law, Act of December 5, 1936, P. L. 1937, p. 2897, 43 P. S. Section 752, constitutes a Declaration of Public Policy with respect to the aims and purposes of the legislature in establishing a system of unemployment compensation. *It is not a mere preamble to the statute, but a constituent part of it and is to be considered in construing or interpreting it.*" (Emphasis supplied)

In refusing to consider Section 2 of the Act the Court in the *Difford* case ignored decisions from Federal Courts holding to the contrary. The following cases hold that the policy section of an act must be read and construed with the entire Act: *Dept. of Labor, etc. v. Unemployment Compensation Board,* (Pa.) 24 A. (2d) 667 (1942); *Securities and Exchange Commission v. Torr,* (S. D., N. Y. 1936) 15 F. Supp. 315, 319-320; *Grossman v. Young,* (E. D. Wis. 1937) 70 F. Supp. 970, 972; *Smolowe v. Delendo Corp.,* 46 F. Supp. 758, 761, 762-3 (S. D., N. C. 1942) Aff. 136 F. (2d) 231 (2d Cir. 1943); *North American Company v. Securities and Exchange Commission,* 327 U. S. 686, 701-702, 90 L. Ed. 945, 957 (1945); *Doyle v. Milton,* (S. D., N. Y. 1947) 73 F. Supp. 281, 284, 285; *Illinois Natural Gas Co. v. Central Illinois P. S. Comm.,* 314 U. S. 498, 86 L. Ed. (1942); *Federal Power Comm. v. Hope Natural Gas Co.,* 320 U. S. 591, 610, 88 L. Ed. 333; *Federal Power Comm. v. East Ohio Gas Co.,* 338 U. S. 464, 468-469, 94 L. Ed. 268, 275; *U. S. v. Wittek,* 337 U. S 346, 352, 93 L. Ed. 1406 (1948).

The following are quotations from some of the foregoing cases:

Securities and Exchange Commission v. Torr, (S.D. N.Y. 1936) 15 F. Supp. 315, 319-320 in considering the Securities and Exchange Act of 1934 based its decision largely upon the findings set forth in Section 2 of the Act and held:

> ". . . But we have the express finding by Congress, in Section 2 of the 1934 Act (15 U.S.C.A. Section 78b), that transactions in securities exchanges are carried on in large voluue by the public generally and in large part originate in other states, that they constitute an important part of the current of interstate commerce, that such transactions are susceptible to manipulation and control, resulting in sudden and unreasonable fluctuations in prices and in great damage.
>
> "In support of these findings Congress had before it voluminous reports of committees that investigated practices in securities dealings.
>
> "Such findings, while not conclusive on the courts, are presumptively sound. They may be overthrown by contrary findings of greater weight, based on facts of common knowledge or on other facts judicially noticed, or on facts proved by the parties asserting invalidity of the statute; but until so overthrown the facts found by the Legislature are to be taken as true. In addition there is always the presumption that the underlying facts support the constitutionality of legislation. *Lindsley v. Natural Carbonic Gas Co.,* 220 U.S. 61, 31 S. Ct. 337, 5 5L. Ed. 369, Ann. Ca. 1912 C, 160; *Block v. Hirsh,* 256 U. S. 135, 154,

41 S. Ct. 458, 64 L. Ed. 865, 16 A.L.R. 165; *O'Gorman & Young v. Hartford Ins. Co.*, 282 U. S. 251, 257, 258, 51 S. Ct. 130, 75 L. Ed. 324, 72 A.L.R. 1163; *Borden's Co. v. Baldwin*, 293 U. S. 194, 209, 55 St. Ct. 187, 79 L. Ed. 281; 38 Harvard Law Review, page 6."

Grossman v. Young, (E. D. Wis.) 70 F. Supp. 970, 972 involving the Securities Exchange Act of 1934, held:

". . . It is the use of inside information in trading on the national exchange and the use of interstate instrumentalities which create the liability. The underlying reasons for this are fully set out in Section 2 of the Act, 15 U.S.C.A. Section 78b—to protect interstate commerce, the national credit, the Federal taxing power, the national banking system, to insure the maintenance of fair and honest markets, to stabilize prices and to prevent excessive speculation and national emergencies."

Smolowe v. Delendo Corporation, (S.D. N.Y. 1942) 46 F. Supp. 758, 761, 762-3, *Aff.* 136 F. (2d) 231 (2d Cir. 1943) also involving the Securities Exchange Act of 1934, held:

"If the section quoted does not apply to the sales and purchases set forth, there will be no need to determine its constitutionality. The first question, therefore, is directed to the application of the section.

"It seems to me that a particular aid in this respect would be to see what wrongs, practices or transactions Congress sought to prohibit, regulate or remedy. In Section 2 of the Act. Congress found that transactions in securities on exchange, or in

over-the-counter markets were affected with a national public interest, and that it was necessary to provide for their regulation and control, including transactions by officers, directors and principal security holders. It deemed this necessary, among others to protect interstate commerce, the national credit and the Federal taxing power, as well as to protect and make more effective the national banking and Federal Reserve systems. It sought to 'insure the maintenance of fair and honest markets in such transactions.' Among other important elements, it distinctly recognized that such transactions constituted an important part of the current of interstate commerce, involved in large part securities of issuers engaged in interstate commerce, affected the national credit, and that the prices established and offered in such transactions constituted a basis for determining prices at which securities are bought and sold. Congress sought, among other things, to control excessive speculation, sudden and unreasonable fluctuations in prices, with their evils of unreasonable expansion and contraction of credit, and the precipitation, intensification and prolongation of national emergencies of unemployment and dislocation of trade and industry. These are some of the matters sought to be comprehended within the four corners of the Act. They have particular significance to the questions here involved.

"The primary purpose of the Securities Exchange Act—as the declaration of policy in Section 2, 15 U.S.C.A. Section 78 (b), makes plain—was to insure a fair and honest market, that is, one which would reflect an evaluation of securities in the light of all available and pertinent data."

North American Co. v. Securities & Exchange Com., 327 U.S. 686, 701-702, 703, 704, 90 L. Ed. 945, 957 (1945) involving Public Utility Holding Company Act of 1935 (15 U.S.C.A. 79r) held:

> "And Congress has plainly recognized that relationship in its declarations of policy in § 1 (a), in its enumeration of abuses in § 1 (b) and in its description of interstate activities of holding companies in § 4 (a). Such statements would be utterly meaningless in the light of reality were they not premised upon the ownership of securities by holding companies and the use of that ownership to burden and affect the channels of interstate commerce."

Doyle v. Milton, (S.D. N.Y. 1947) 73 F. Supp. 281, 285 involving the Investment Company Act, held:

> "The Investment Company Act is a carefully framed statute in which Congress has, with particularity, stated the means and methods, both judicial and administrative, by which its declaration of policy is to be executed. It has not confided in the Courts a broad discretion to shape judicially contrived remedies for the mischief it has discovered. Insofar as power is entrusted to the courts under this Act its exercise must, of course, be steered toward the fulfillment of the national policy as declared. *The policy itself, however, when declared in a statute as comprehensive and detailed as this Act, does not authorize the courts to fashion sanctions withheld by Congress.*" (Emphasis ours).

Illinois Natural Gas Co. v. Central Illinois Public

Service Co., 314 U. S. 498, 506-507, 86 L. Ed. 471 (1942) involving the N.G.A., held:

> "An avowed purpose of the Natural Gas Act of June 21, 1938, was to afford, through the exercise of the national power over interstate commerce, an agency for regulating the wholesale distribution to public service companies of natural gas moving interstate, which this Court had declared to be interstate commerce not subject to certain types of state regulation. H. Rep. No. 709, Committee on Interstate and Foreign Commerce, 75th Cong., 1st Sess., April 28, 1937. By its enactment, Congress undertook to regulate a defined class of natural gas distribution, without the necessity, where Congress has not acted, of drawing the precise lines between State and Federal power by the litigation of particular cases. By § 1 (b) 15 U.S.C. § 717(b), the Act is restricted in its application 'to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas copanies engaged in such transportation or sale . "

The court in the *Difford* case ignored the extensive legislative materials cited in the briefs, when on page 148 of the opinion it said:

> "Likewise, the legislative history of an act may not properly be considered in construing an unambiguous statutory provision such as Section 10 (b)."

In the first place, the court is making an unwarranted assumption because, as we pointed out above,

the court finds Section 10 (b) unambiguous by refusing to construe the entire Act as a whole. Such casual disregard of the extensive legislative materials cited in the briefs must come as a surprise to anyone who reads the Federal Advance Sheets and particularly those of the Supreme Court, knowing that of recent years the Supreme Court in particular has resorted to legislative history as well as to legislative materials in almost every case where a problem of statutory construction is before it.

In *United States v. American Truckers Association, Inc.*, 310 U. S. 534, 543, 84 L. Ed. 1345, (1940) the court said:

> "When aid to construction of the meaning of words, as used in the statute, is available, there certainly can be no 'rule of law' which forbids its use, however clear the words may appear on 'superficial examination'."

In this connection see the dissenting opinion of Justice Frankfurter in *United States v. Monia,* 317 U. S. 424, 431, 87 L. Ed. 376 (1943) wherein it was said:

> "This question cannot be answered by closing our eyes to everything except the naked words of the Act of June 30, 1906. The notion that because the words of a statute are plain, its meaning is also plain, is merely pernicious over-simplification. It is a wooden English doctrine of a rather recent vintage (see Plucknett, a Concise History of the Common Law, 2d Ed., 294-300; Amos, the Interpretation of Statutes, 5 Camb. L. J. 163;

> Davies, The Interpreation of Statutes, 35 Col. L. Rev. 519, to which lip service has on occasion been given here, but which since the days of Marshall this Court has rejected, especially in practice. E.g., United States v. Fisher, 2 Cranch 358, 385-86; Boston Sand Co. v. United States, 278 U. S. 41, 48; United States v. American Trucking Assns., 310 U. S. 534, 542-44. A Statute, like other living organisms, derives significance and sustenance from its environment, from which it cannot be severed without being mutilated. Especially is this true where the statute, like the one before us, is part of a legislative process having a history and a purpose. The meaning of such a statute cannot be gained by confining inquiry within its four corners. Only the historic process of which such legislation is an incomplete fragment—that to which it gave rise as well as that which gave rise to it—can yield its true meaning. And so we must turn to the history of Federal immunity provisions."

In the case of *Commissioner of Internal Revenue v. Estate of Church*, 335 U. S., 632 and 687 93 L. Ed. 289, at 321 (1948) where Justice Frankfurter under the heading of "Decisions During the Past Decade in Which History was Decisive of Construction of a Particular Statutory Provision" lists two and one-half pages of citations.

Without reviewing the mass of case law on this subject suffice it to say that the following citations clearly presents the practice of the Supreme Court of the United States.

In *United States v. Dickerson*, 310 U. S. 554, 561-

562, 84 L. Ed. 1356, 1362 (1939) the court said:

> "The respondent contends that the words of Sec. 402 are plain and unambiguous and that other aids to construction may not be utilized. It is sufficient answer to deny that such words when used in an appropriation bill are words of art or have a settled meaning. See *United States v. Perry*, 50 F. 743, 748 (C. C. A. 8th). The very legislative materials which respondent would exclude refute his assumption. It would be anomalous to close our minds to persuasive evidence of intention on the ground that reasonable men could not differ as to the meaning of the words. legislative materials may be without probative value, or contradictory or ambiguous, it is true, and in such cases will not be permitted to control the customary meaning of words or overcome rules of syntax or construction found by experience to be workable; they can scarcely be deemed to be incompetent or irrelevant. See *Boston Sand & Gravel Co. v. United States*, *supra*, at 48. The meaning to be ascribed to an Act of Congress can only be derived from a considered weighing of every relevant aid to construction."

In *Harrison v. Northern Trust Co.*, 317 U. S. 476, 479, 87 L. Ed. 407, 410, the Supreme Court said:

> " . . . In so doing, the court below refused to examine the legislative history of § 807, on the ground that the section was unambiguous.
>
> "But words are inexact tools at best, and for that reason there is wisely no rule of law forbidding resort to explanatory legislative history no matter how 'clear the words may appear on superficial examination'."

It is appellees' position that Judge Grimm arrived

at a wrong result in the *Difford* case because he got off to a wrong start when he found Section 10 (b) unambiguous. Judge Grimm simply read Section 10 (b) of the Act and from a reading of this particular section in isolation from the others came to the conclusion that Section 10 (b) was not ambiguous in that the language was plain that it covered "any security registered on a National Securities Exchange *or any security not so registered.*"

From a reading of this particular section in isolation Judge Grimm concluded that this section of the Act was not ambiguous by reasoning that a security "not so registered" would automatically cover any other security whether sold in the "over-the- counter" market or not. At this point it should be kept in mind that Judge Grimm definitely recognized an "over-the-counter" market as being limited in its scope and not covering all sales of securities. See footnote 3, p. 148 of *Difford* opinion. Electing to isolate Section 10 (b) of the Act from the remainder thereof it was quite easy for Judge Grimm to find that Section 10 (b) *standing by itself* was not ambiguous. Having arrived at this result he then concluded that there was no need to examine what he erroneously termed the "preamble" of the Act nor was it necessary to examine the legislative materials submitted to him. However, it is our opinion that Judge Grimm committed error in the first premise of his reasoning when he elected to read Section 10 (b) in isolation from the remainder of

the Act and then simply found Section 10 (b) unambiguous. As has already been pointed out, nothing is more fundamental in statutory construction than that the entire Act must be read and construed as a whole and that one section cannot be isolated and read apart from the other sections. THE TEST IS NOT WHETHER SECTION 10 (b) IS AMBIGUOUS BUT RATHER, WHETHER THE ENTIRE ACT TAKEN BY ITS FOUR CORNERS IS AMBIGUOUS. When the entire Securities and Exchange Act of 1934 is read as a whole it becomes more than apparent that the term "any security not so registered" as used in Section 10 (b) of the Act has a particular and definite meaning and is simply another way of referring to securities that are sold in an "over-the-counter" market. This conclusion is plain from a reading of Section 2 of the Act. Section 2 is not a "preamble" but is a part of the Act itself. Section 2 definitely limits the coverage of the entire act to securities that are sold on a National Securities Exchange or traded in an "over-the-counter" arket. IT IS ONLY THESE TWO TYPES OF TRANSACTIONS THAT CONGRESS WAS REGULATING. Thus, when the entire act is read as a whole Section 10 (b) must be read in conjunction with Section 2 and when this is done it becomes apparent that Section 10 (b) cannot be read literally but must be read in harmony with Section 2.

It seems plain to appellees and likewise it seemed plain to Judge McLaughlin below that had Congress

intended Section 10 (b) to apply to transactions in *all securities* as a "blanket" proposition that all Congress would have to do was use the words "all securities" or "all transactions." Instead, Congress used the peculiar words "any security not so registered," and to find the meaning of this latter term one must read the entire Act and particularly Section 2 thereof.

Where a general statute consists of numerous sections as does the Securities and Exchange Act of 1934 anyone can pick out one particular section of any act and find that that particular section standing alone and isolated from the others, is not ambiguous. Ambiguity, if any, in a general statute, only arises, if it does at all, when all sections are read and construed together. Had Judge Grimm applied the test of ambiguity to the entire act rather than to just one section thereof, he would have found as did Judge McLaughlin in the court below, that either section 2 of the Act itself plainly limited the coverage of the Act to Securities that had been sold on a National Securities Exchange or in an "over-the-counter" market or if such was not plain from the reading of the Act itself, that there was sufficient ambiguity in the entire act to make resort to legislative materials both necessary and proper.

Digressing for a moment to *Speed v. Trans-America Corp.*, the court on page 830 of the opinion said:

"In short, Congress did not intend to limit ap-

> plication of the Act to transactions on exchanges and in the organized over-the-counter markets maintained by brokers and dealers."

In face of the specific limitation made by Congress in Section 2 of the act itself and confronted with positive statements as to the meaning of the term "over-the-counter" by Vice-President Barkley and Speaker Rayburn (then members of the Senate and House respectively) during the debate on the bill, together with definitions from other legislators, writers and Security and Exchange Commission officials we cannot account for the above conclusion so confidently reached by Judge Leahy in the *Trans-America* case unless it was that he did not have the benefit of Judge McLaughlin's views and was not presented, by way of briefs, the materials submitted here.

Also, while touching upon the case of *Speed v. Trans-America* there appears on page 830 of the opinion, footnote 11, a statement of Wallace R. Fulton, Executive Director of National Association of Securities Dealers, Inc., which, at first glance, would seem to be counter to our definition as to what constitutes "over-the-counter" markets. However, Mr. Fulton's statement is taken out of context and if his entire statement is read it becomes apparent that he is discussing a market maintained by brokers and dealers off a regular exchange. For Mr. Fulton's full statement see Appendix "B", page 77.

This court may well take judicial notice that there are many small family corporations in the United States operating corner meat markets, neighborhood garages and other small businesses. By and large, this stock is never sold unless it be to an employee, relative or friend. There is no established market for it, "over-the-counter" or otherwise. Manifestly, it was never the intent of Congress to control or regulate a sale of stock when, for example, the owner sold a few shares to his son in the armed services, even though the check in payment thereof was sent by mail. Such a transaction involves no National public interest.

In reviewing the opinion of Judge Grimm in the *Difford* case and observing the casual manner in which he brushed aside Section 2 of the Act, which Section was a deliberate statement of intent and purpose, and also ignored the volume of legislative material submitted to him one can only read in an ironical fashion Senator Alben Barkley's remarks during debate on the bill:

> "*Mr. Barkley.* Section 2 of the bill itself says that only those are included in the proposed law. Why should anyone imagine that someone else will be included in it."

We are making the precise point in this court that Senator Barkley made on the Senate floor and we agree with Judge McLaughlin in the court below when he refused to follow the holding of the *Difford* case and only wish that Judge McLaughlin's views had been

made available to Judge Leahy prior his deciding the *Trans-America* case.

The Securities and Exchange Commission at page 58 of their brief as *amicus curiae* frankly admit that two Harvard Law Review articles do not support the Commission's contention in this matter. (61 Harvard Lawe Review 858, quoted at page 22 of appellee's brief, and 64 Harvard Law Review 1018, quoted in full in Appendix "C," page 79 of appellees' brief.) The Commission apparently argues that because these are student articles, and also appear to be summary of appellees' argument, that little weight should be given to them. However, it seems to us, that when two student articles, written at different times, definitely support appellees' position in this case that although not binding as precedent, such articles should be given considerable weight. Whether a Law Review article is written by a student, under the supervision of his Professor, or whether it is written by the Professor alone, is beside the point. The only question to be asked is whether or not the article stands the test of reasoning and analysis. If it does it should be accorded considerable weight in any forum

Appellees fully realize that the Securities and Exchange Commission is desirous of extending its powers to cover all stock transactions, even the isolated doorstep sales, and however meritorious this policy might be we strongly feel that such can only be accomplished by Congress and not by the Courts.

The Securities and Exchange Commission, in an effort to minimize the persuasive impact of the Legislative debate upon the bill, argue, on page 48 of their brief, that the legislators who participated in the debate were not discussing the "concept of the scope of the over-the-counter market generally," but were limiting their discussions to Section 15 (2) of the Act. We certainly cannot agree with the Commission in this respect. The facts are clearly against their contention.

The statement made by Mr. Rayburn, supra, as to the meaning of the term "over-the-counter market," was not limited merely to Section 15 (2). Indeed, Mr. Rayburn said:

> "'Over-the-counter market,' *as used in this bill*, refers to a market maintained off a regular exchange by one or more dealers or brokers. The market must be maintained both for the purchase and sale of the securities in question . . . " (Emphasis ours).

Note Mr. Rayburn's language, "*as used in this bill.*" How, then, can it seriously be argued that he was limiting his remarks to Section 15 (2) only?

The Court's attention is respectfully invited to the colloquy on the Senate floor, between Senator Dill and Senator Barkley, the context of which appears earlier in this brief. Senator Dill said, in part:

> "*It it is the intent of this bill* not to include corporations whose stock is not so registered on an

> exchange or not dealt in over-the-counter . . . ." (Emphasis supplied).

To which Mr. Barkley replied:

> "Section 2 *of the bill itself* says that only those are included in the proposed law. Why should anyone imagine that someone else will be included in it?" (Emphasis supplied).

Again it must be observed that both Senators Dill and Barkley were talking about "*the bill*" and not just Section 15 (2).

Attention is again invited to the ramarks of Senator Steiwer's (78 Cong. Rec. 8189) set forth in Appendix A, p. 67 The Senator said, in part, as follows:

> "In the first place, *this bill* deals with stock exchanges, and with the regulation of the over-the-counter market." (Emphasis supplied).

We find nothing limiting Senator Steiwer's remarks to Section 15 (2). On the contrary he is speaking about the entire bill.

To the same effect are the statements made by Representative Maloney (78 Cong. Rec. 7869) set out in Appendix A, and quoted, in part, below:

> "A dealer or broker creates or maintains an over-the-counter market *as it is defined in the bill* only if he stands ready both to buy and sell." (Emphasis supplied).

It seems more than apparent that Mr. Maloney was speaking of an over-the-counter market "*as it is de-*

fined in the bill" and we find no indication that his remarks were expressly limited to Section 15 (2).

To argue, as does *amicus curiae*, that the foregoing statements, which constitute an important part of the legislative history of the Securities Act of 1934, are limited to Section 15 (2) only, and do not apply to the entire Act, is indeed unique, but not, in our opinion, equally convincing.

The Securities and Exchange Commission on page 64 of their brief are concerned that appellees' construction of the act (and presumably Judge McLaughlin's also) would in substance mean that a fraudulent transaction in a security which had never been registered on a national exchange or sold in an "over-the-counter" market could not be remedied under the Federal Act but only under local State law. The Commission complains about the insufficiency of many, if not most, state laws to deal effectively with such transactions. Finally, the Commission concludes that "such a view of the scope of the Federal statute would 'turn back the clock' a long way."

We do not agree and apparently Congress did not agree that the state laws are as inadequate as the Commission believes for it must be remembered that it was Congress, and not the courts, that limited the application of the Act to securities registered on a national exchange or sold in an "over-the-counter" mar-

ket. Indeed, the only question to be determined by this court, with reference to the subject matter at hand, is whether the sale of a security that has never been registered on a national exchange or sold in an "over-the-counter" market is within the purview of Section 10 (b) of the Securities and Exchange Act of 1934. Appellees are not contending that Congress could not have regulated such a transaction. All we are saying is that Congress, not deeming such transactions affected with a sufficient national interest, simply did not elect to use its regulatory powers in this particular respect. If the Federal Act in its present form and as construed by Judge McLaughlin and the various law review writers is not, in the opinion of the SEC, broad enough to sufficiently protect the national interest, then it seems to us that the Securities and Exchange Commission should invite congressional attention to this fact rather than urge the courts to expand the legislative intent. Courts cannot and should not enlarge or expand a statute, particularly a criminal statute, beyond the limits fixed by Congress. Neither should courts nor lawyers who correctly interpret a statute be necessarily charged with "turning back the clock." At this point it might be well to inquire upon what basis the clock has ever been "turned ahead." No appellate court has ever approved the all-inclusive construction of the Securities and Exchange Act of 1934 as now contended for by *amicus curiae*. As a matter of fact, and regardless of what is said in the Com-

mission's brief, it is doubtful whether the Securities and Exchange Commission itself has ever actually acknowledged the enlarged construction of the act for which they are now arguing.

There is one thing about the Commission's present position, as *amicus curiae*, which is unusually startling to us. In their brief as *amicus curiae* they are contending (1) that the Act covers all security transactions without any limitation whatever, and (2) that the sale of any security, other than on a national exchange, is a sale in the "over-the-counter" market. Such has not always been their position and there is some doubt in our mindss whether it is in fact their sincere position at this time—especially when the commission and its officials have consistently heretofore offered a contrary view. Earlier in this brief we set forth a portion of an address entitled "Fraud On The Seller of Securities" by Edward H. Cashion, Counsel to the Corporation Finance Division, Securities and Exchange Commission (1944) wherein, as attorney for the Commission, he said in part:

> "The Securities Exchange Act of 1934 and its subsequent amendments were designed to regulate trading in securities—the purchase and sale of securities—*on national exchanges and in over-the-counter markets, and to regulate brokers and dealers.*" (Emphasis ours).

As late as 1944 Mr. Cashion was of the opinion that

the act only applied to securities on national exchanges and in the "over-the-counter" markets.

As late as 1948 the Securities and Exchange Commission itself in their 14th Annual Report at page 24 said, in part:

> "The Securities Exchange Act of 1934 is designed to eliminate fraud, manipulation, and other abuses in the trading of securities *both on the organized exchanges and in the over-the-counter markets, which together constitute the nation's facilities for trading in securities. . . . .*" (Emphasis ours).

Again, no mention is made by the Commission that the Act was designed to cover every transaction in securities as a blanket proposition.

Although the commission now argues that the term "over-the-counter" market includes all securities not sold on a national exchange, yet such a contention has not always been the case. The court will no doubt notice that the Commission's brief, as *amicus curiae*, as shown on the cover, was prepared under the direction of *Mr. Louis Loss, Associate General Counsel for the Commission. Mr. Loss* in the Commission's brief now argues that the term "over-the-counter" includes all security transactions not occurring upon a national exchange. It is hard for appellees to reconcile *Mr. Loss's* position as argued in the Commission's brief, especially when the *same Mr. Loss* as late as 1947 distributed mimeographed material entitled "Cases and

Materials on SEC Aspects of Corporate Finance," (Philadelphia, May, 1947), and on page 119 said:

> "The over-the-counter markets, in general, are the unorganized markets in which there are meetings of individual supply and demand as contrasted with the organized markets or exchanges where there are meetings of collective supply and demand. *Over-the-counter transactions take place in the office of brokers and dealers and do not involve the trading facilities of an exchange.*" (Emphasis ours).

If, as *Mr. Loss* said in 1947, "over-the-counter transactions take place in the offices of brokers and dealers," we, as appellees, find it exceedingly difficult to comprehend *Mr. Loss's* present position where, on page 40 of the Commission's brief, he informs this court that Judge Grimm's definition of the term "over-the-counter" markets as set forth in footnote 3, page 148 of the *Difford* opinion "improperly narrows the concept of over-the-counter markets." This is especially not understandable when *Mr. Loss's* earlier definition in 1947 and Judge Grimm's definition in the *Difford* case both recognize the concept that the "over-the-counter" markets involves securities traded through brokers and dealers.

In view of the Commission's earlier construction of the Act, which nearly paralleled appellees' present position, we are at somewhat of a loss to understand how the Commission can now reasonably justify its complete reversal and argue, in their brief, contrary to their previous public statements.

It seems to us, as it apparently did to Judge McLaughlin, that the result in the *Difford* case is erroneous because the court failed to take into consideration the following:

(1) The purpose and scope of the Act as it appears from an analysis of all its provisions.

(2) The express limitation of the Act as set forth Section 2.

(3) The Commission's inaction with respect to the issue in question for a period of eight years.

(4) The conclusions reached by the Senate and House Committees advocating the passage of the bill.

(5) The expressed intent of the legislators during debate on the bill.

(6) The elementary canon of statutory construction which requires the Court to interpret so that no words or phrases are rendered superfluous.

(g) Limited Jurisdiction of Federal Courts

The jurisdiction of a Federal Court being limited, and not general, the presumption is again jurisdiction, unless it affirmatively appears. Jurisdiction cannot be presumed or inferred. *Hanford v. Davies*, 163 U.S. 273, 279, 16 S. Ct. 1051, 41 L. Ed. 157, (1896); *Metcalf v. Watertown*, 128 U.S. 586, 9 S. Ct. 173, 32 L. Ed. 543, (1888); *Smith v. McCullough*, 270 U.S. 456, 46 S. Ct.

338, 70 L. Ed. 682 (1926); *Norton v. Sarney*, 266 U.S. 511, 515, 45 S. Ct. 145, 69 L. Ed. 413 (1925). The burden of establishing the jurisdiction of the Federal court is throughout the case, and at all times, on the plaintiff, and this burden never shifts. *McNutt v. General Motors Accept. Corp.*, 298 U.S. 178, 56 S. Ct. 780, 80 L. Ed. 1135 (1936); *KVOS v. Associated Press*, 299 U.S. 269, 57 S. Ct. 197, 81 L. Ed. 183 (1936). These rules apply to jurisdiction of the subject-matter as well as to other aspects of Federal jurisdiction. *United States v. Griffin*, 303 U.S. 226, 58 S. Ct. 601, 82 L. Ed. 764 (1938); *United States v. Corrick*, 298 U. S. 435, 440, 56 S. Ct. 829, 80 L. Ed. 1263 (1936). This question may even be raised by a Federal court or by the Supreme Court, on its own motion. *Clark v. Paul Gray, Inc.*, 306 U.S. 583, 59 S. Ct. 744, 83 L. Ed. 1001 (1939; *Rorick v. Board of Commissioners*, 307 U.S. 208, 59 S. Ct. 808, 83 L. Ed. 1242 (1939).

Manifestly, unless the jurisdiction of a Federal court is clear, and without substantial doubt, it should not be taken. This is especially so where, as here, an appropriate forum exists in which there is undoubted jurisdiction.

We respectfully submit that this court is clearly without jurisdiction of the subject-matter of this action.

The Securities Exchange Act of 1934 Does Not Provide a Civil Right of Action Under Section 10 (b).

Appellees are aware of the fact that several district courts, following the lead of the court in the case of *Kardon v. National Gypsum Co.*, (E. D. Pa.), 69 F. Supp. 512, have held to the contrary. These, being cases in district courts, are not binding upon this court. The Court of Appeals for the Ninth Circuit has not yet passed upon this question.

Appellees frankly concede that the Second Circuit in *Fischman v. Raytheon Mfg. Co.*, 188 F. (2d) 783, 787, ruled adversely to our contention, in the following language:

> "Section 10 (b) ,to be sure, does not explicitly authorize a civil remedy. Since, however, it does make 'unlawful' the conduct it describes, it creates such a remedy."

It is thus apparent, from the foregoing quotation, that none of the contentions which we are making here were passed upon by the Court.

The cases of *Osborne v. Mallory*, D.C. S.D. N.Y., 86 F. Supp. 869, and *Slavin v. Germantown Fire Insurance Company*, 3 Cir., 174 F. 2d 799, 805, are not persuasive.

In the *Slavin* case the defendants did not dispute the failure of the Act to specifically permit private litigation for violation of Section 10 (b).

Prior to the *Kardon* case, commentators in discussing the Securities and Exchange Act of 1934, had noted that although several other sections of the Act

expressly provided for similar remedies that Section 10 did not, and had questioned, therefore, whether Section 10 could give rise to a civil action for the benefit of private parties.

> "However, since other sections of the Act specifically grant remedies to persons injured by violations of their terms, the inference is strong that the omission of such a provision in Section 10 (b) indicates a congressional intent that parties injured by its infringement should be left to their common-law remedies."
>
> 59 Harv. L. Rev. 769, 779.

In the *Kardon* case it was held that even though Section 10 of the Act provides no civil remedy, a remedy would be implied under the general rule that a violation of the criminal statute may give rise to a civil remedy. As an abstract proposition, that is sound law and would be persuasive if no other section of the Act provided specifically for a civil remedy. But here we are dealing with an Act carefully drawn, penal in character, with a number of specific sections, spelling out civil liability and providing a specific Statute of Limitations. These sections are as follows:

> Section 9 (U.S.C.A. Section 78i (e));
> Section 16 (15 U.S.C.A. Section 78p (b));
> Section 18 (15 U.S.C.A. Section 78r);
> Section 29 (15 U.S.C.A. Section 78 cc (b)).

Thus, in four other sections of the Act, a civil remedy is specifically provided. If Congress intended that a violation of Section 10 should give rise to civil reme-

dies, it is unbelievable that it would not have specifically so provided when in four other sections (above quoted) the Act specifies provision for civil remedies.

We submit that the clearest expression of legislative intent in these instances is the specific omission of a provision for civil remedy in Section 10 when it is specifically provided for in four other sections of the Act.

Section 9 of the Act (15 U.S.C.A., Section 78i) is nearly identical with Section 10 except that Section 9 specifically provides a civil remedy. It seems incredible that Congress, in enacting two successive sections of the Act dealing with prohibited practices, would place a specific section relating to civil remedies in Section 9 and not likewise rewrite it into the next succeeding section, Section 10, if such had been the Congressional intent.

The construction for which we are contending of Section 10 does not mean that that section becomes meaningless because violations of the section subject a person to the injunctive remedies provided for in Section 21, (15 U.S.C.A., Section 78 (u)) and would also subject a violator to the penalties provided for in Section 32 of the Act, (15 U.S.C.A., Section 78ff.) Moreover, insofar as civil remedies are concerned, any person claiming to have been injured by practices which violate Section 10 and Rule X-10-B-5 can bring his common law action for deceit in the appropriate court.

In conclusion, we submit that the only rational approach is that Congress, in enacting the Securities Exchange Act of 1934, so carefully drawn and so carefully considered, provided for civil remedies where Congress intended that they should exist and did not provide for them where the intent was that a violation of that particular section of the Act should not give rise to a civil action.

The Complaint Does Not Allege Sufficient Use of the Mails to Confer Federal Jurisdiction Under Section 10 of the Securities and Exchange Act.

Paragraph V of the complaint (Tr. 6) alleges certain acts "by the use of the mails" and other means of interstate commerce "at times hereinafter set forth." Further along in the complaint is Paragraph XV (Tr. 16), which is the "hereafter" paragraph referred to containing only the single allegation that the mails were used when a letter was sent by an Everett bank, at defendants' request, directed to a bank in Seattle, authorizing the latter bank to credit plaintiff's account. Thus there is presented the single question of whether the use of the mails as alleged in Paragraph XV is sufficient to confer Federal jurisdiction under Section 10 (b) of the act.

In *Kemper v. Lohnes,* (C.C.A. 7, 1949) 173 Fed. 2d 44, the complaint alleged that plaintiff read an ad-

vertisement in a newspaper offering stock for sale, wrote a letter to defendant evidencing interest, received a letter suggesting an appointment and subsequently purchased stock upon misrepresentations. Action was commenced under Section 12 of the Securities and Exchange Act of 1933 (15 U.S.C.A. 771). It was held that inasmuch as the mails were not used for the making of any untrue statements that Federal jurisdiction was not conferred.

The court in the *Kemper* case, *supra*, refused to follow the reasoning or the holding in an earlier case of *Schillner v. H. Vaughan Clark and Co.*, (C.C.A.2d) 134 Fed. 2d 875, a case under the same act, where it was held that the delivery of stock certificates by mail was a part of the sale and sufficient to invoke Federal jurdiction.

The answer to our specific question lies in the language of Section 10 (b) of the act itself, which section may be reduced for the purpose of our immediate inquiry, as follows:

> "It shall be unlawful . . . directly or indirectly . . ., by the use . . . of the mails, . . . to use or employ, ...any manipulative or deceptive device . . ."

Rule X-10b-5 can similarly be reduced as it contains identical language. It seems clear that the sending of the letter as alleged in Paragraph XV of the complaint does not bring appellant within the purview or scope of the statute or the rule because it is not alleged that

the mails were used for any manipulative or deceptive device.

The cases cited on page 37 of appellant's brief, with the exception of the *Slavin* case, to appellees' knowledge, involved different statutes containing different language and are not controlling here. *Slavin v. Germantown Fire Insurance Co.* (C.C.A. 3rd 1948) 174 F. 2d 799, did involve Section 10 (b) of the act but its controlling force is lost inasmuch as on page 801 of the opinion it is said that defendants conceded that there was such a use of the mails as to confer jurisdiction.

The Cause of Action Is Barred by the Statute of Limitations.

There being no statute of limitations provided in the Securities Exchange Act of 1934 relating to actions arising out of Section 10 (assuming that they can arise), the applicable statute would be that of the forum, or in this case, the State of Washington. *Osborne v. Mallory*, D.C. S.D. N.Y., 86 F. Supp. 869, 879.

Before considering the applicable statute of limitations in the State of Washington it is necessary to consider what type of action is involved. The appellant undoubtedly would concede that it is an action based upon a statute, namely, the Securities Exchange Act of 1934 and Section 10 thereof. Otherwise they are not

properly in this court, there being no diversity of citizenship.

A cause of action arising under Section 10 of the Securities Exchange Act of 1934 (15 U.S.C.A., § 78 (a) et seq.) is a cause of action arising out of a statute. *Osborne v. Mallory, supra,* 86 F. Supp. 869, 879; *Hall v. American Cone & Pretzel Co.,* D.C. E.D. Pa., 71 F. Supp. 266, 269; *Acker v. Shulte,* D.C. S.D. N.Y., 74 F. Supp. 683, 688; *Frye v. Schumaker,* D.C. E.D. Pa., 83 F. Supp. 476, 478; *Rosenberg v. Hano,* 3 Cir. 121 F. 2d 818, 820; *Pennsylvania Company for Insurances, etc. v. Dackert,* 3 Cir., 123 F. 2d 979, 985.

The cause of action, if any, accrued, under the allegation of the complaint, with the use of the mails in September, 1945, in connection with the alleged fraudulent purchase of stock from the plaintiff. In *Osborne v. Mallory,* 86 F. Supp. 869, 873-874 (D.C. N.Y. 1949)it was held:

> "In the case at bar the violation took place when inter-state facilities were used by the defendants in connection with the sales made to the various plaintiffs, etc."

The complaint in this case was filed on April 19, 1951, more than five (5) years subsequent to the time the cause of action, as alleged in the complaint, accrued.

Remembering, then, that this is a cause of action based upon a statute, the applicable statute of limi-

tations in the State of Washington is two (2) years. The statute in question reads as follows:

> "An action for relief not hereinbefore provided for shall be commenced within two years after the cause of action shall have accrued."
>
> Rem. Rev. Stat. § 165.

The Supreme Court of the State of Washington, in interpreting the above statute, has held many times that this is the section which applies to actions to recover on a liability created by statute.

Thomas v. Richter, 88 Wash. 451, 153 Pac. 333; *Douglas County v. Grant County*, 98 Wash. 355, 167 Pac. 928; *Robinson v. Lewis County*, 141 Wash. 642, 252 Pac. 143, 256 Pac. 503; *Noble v. Martin*, 191 Wash. 39, 70 P. 2d 1064; *Heitfeld v. Benevolent and Protective Order of Keglers*, 136 Wash Dec. 637, 220 P. 2d 655.

The court of appeals for this circuit, in a case brought to recover overtime pay and damages under the Fair Labor Standards Act, 29 U.S.C.A., § 201, et seq., recognized that under the law of the State of Washington the applicable statute of limitations on a liability arising out of a statute was two (2) years. *Lassiter v. Guy F. Atkinson Company*, 9 Cir., 162 F. 2d 774.

This action not having been commenced within two (2) years after the alleged cause of action accrued, should be dismissed.

Even assuming that the statute commences when the alleged fraud is discovered it still is that the action is barred under the two (2) year statute. The complaint alleges the fraud was discovered subsequent to January, 1945. Therefore, it was known prior to January 31, 1945. The complaint was filed April 19, 1951, more than two (2) years later.

If appellant takes the position that this is not a statutory action in order to avail herself of the three (3) year statute she is out of court for lack of jurisdiction. If appellant maintains that the action is based purely upon a Federal statute (SEC Act.) in order to avail herself of Federal jurisdiction then the two (2) year statute is applicable and her action is barred.

CONCLUSION

It is submitted that the judgment of dismissal should be affirmed.

Respectfully submitted,

O. D. ANDERSON *and*
J. P. HUNTER,
Attorneys for All Defendants except W. E. Difford.

ALFRED J. SCHWEPPE
and M. A. MARQUIS,
Attorneys for Defendant W. E. Difford.

APPENDIX "A"

Statements of Senators and Congressmen as to the Intent of the Securities and Exchange Act of 1934.

The following are excerpts from the Senate and House Committee Reports on the Securities and Exchange Act:

> "In addition to the organized security markets there exist in financial centers unorganized 'over-the-counter' markets where securities are bought and sold in large volume. Many of these securities are of a conservative character, such as Government, State and Municipal bonds which are exempted from the provisions of the bill; but others are more speculative in nature and are subject to the abuses of manipulation. For example, the Committee has heard of extensive manipulation in certain New York bank stocks after their withdrawal from the New York Stock Exchange and while they were being sold 'over the counter.' These manipulations resulted in tremendous losses to the investing public, and in enormous profits to insiders. It has been deemed advisable to authorize the Commission to subject such activities to regulations similar to that prescribed for transactions on organized exchanges. This power is vitally necessary to forestall widespread evasion of stock exchange regulation by the withdrawal of securities from listing on exchanges, and by transferring trading therein to 'over-the-counter' markets where manipulative evils could continue to flourish, unchecked by any regulatory authority. Since the necessity for regulation of 'over-the-counter' markets will depend largely on the extent to which activities prohibited on exchanges are transferred

to such markets, provision for their regulation has been made as flexible as possible." (Senate Report No. 792, p. 6, 73d Cong. 2d Sess.)

and in House Report No. 1383, the following is stated:

"REASON FOR CONTROL OF OVER-THE-COUNTER MARKETS.—The Committee has been convinced that effective regulation of the exchanges requires as a corollary a measure of control over the 'over-the-counter' markets. The problem is clearly put in the recent report of the Twentieth Century Fund on 'stock market control':

"The benefits that would accrue as the result of raising the standards of security exchanges might be nullified if the over-the-counter markets were left unregulated and uncontrolled. They are of vast proportions and they would serve as a refuge for any business that might seek to escape the discipline of the exchanges; and the more exacting that discipline, the greater the temptation to escape it. Over-the-counter markets offer facilities that are useful under certain conditions, but they should not be permitted to expand beyond their proper sphere and compete with the exchanges for business that, from the view of the public interest, should be confined to the organized markets. *This constitutes the sanction for federal regulation of over-the-counter dealers and brokers.* To leave the over-the-counter markets out of a regulatory system would be to destroy the effects of regulating the organized exchanges." (House Report No. 1383, P. 15, 16, 73d Cong. 2d Sess.) (Emphasis supplied).

Mr. Maloney said:

"If one wants to put effective restraints upon

excessive speculation on the exchanges, it is obviously necessary to guard against the same sort of excessive speculation on the unregulated markets. But those who tell you that the over-the-counter provisions of the bill will interfere directly with the small industrial concern are either wilfully misleading you or are ignorant of what the bill really does. *The control of the Commission with respect to the over-the-counter markets may be exercised only over dealers or brokers who maintain a public market.* The Commission has no power to cause any corporation to file any statement or to subject itself in any way to regulation. Even the dealer or broker is not subject to control if he does no more than to try to find a buyer for a person who wants to sell some shares or to find a seller for a person who wants to buy some shares. *A dealer or broker creates or maintains an over-the-counter market as it is defined in the bill only if he stands ready both to buy and sell;* that is, if he stands ready to quote you a price at which he will buy your shares as well as a price at which he will sell your shares." (78 Cong. Record, p. 7868). (Emphasis supplied).

"This bill is primarily designed to prevent a manipulation of securities—the kind of manipulation that threatened the lives of the insurance companies of America, and thereby the humble estates men endeavored to create by the sweat of the brow and real self sacrifice. It would remove a chance at manipulation that not only threatened the banking system of the country but actually left many banks broken wreckage upon the rocks. It would forever forbid a manipulation that boiled a market to the point where it attracted credit away from the proper channels of industry into uncertain paths of speculation." (Ibid p. 7869).

Mr. Mapes, a member of the House Committee on Interstate and Foreign Commerce, stated at page 7711 of the Record:

> "And the only provision in the bill that relates to small or local corporations in that respect, as I understand it, is the one in the over-the-counter market section, which gives the . . . Commission authority in its regulations of dealers and brokers in the over-the-counter markets to require that such dealers and brokers cease to handle the securities of any corporation unless they are listed with them, but in no case is a corporation required ot so list unless it sees fit to do so."

And Mr. Steiwer stated at page 8189:

> "I merely want to make a suggestion. Is it not appropriate, in order to calm the fears of those who now raise the question as to the inclusion of small intrastate corporations, to say to them that the bill by its term does not and cannot reach such corporations. In the first place, *this bill deals with stock exchanges, and with the regulation of the over-the-counter market.* The very least corporation, if it should seek to list its stock upon the stock exchange, would be obliged to comply with this proposed law. That might be so even though it were an intrastate institution, because the stock exchange may be engaged in an interstate business and the intrastate operation comes in quite incidentally.
>
> I think, therefore, the very least corporation might subject itself to regulation under this proposed act if it should seek to sell its securities over the counter. *But unless the stock crosses the threshold of one of these institutions or the other,*

it is not affected by the proposed law, whether it be a big institution or a little institution." (Emphasis supplied). (78 Cong. Rec. 8189).

Note: The stock of the Robinson manufacturing Company never at any time crossed the threshold of one of these institutions or the other.

APPENDIX "B"

1. Over-the-Counter Markets—Defined by Securities and Exchange Commission and Text Writers.

Mr. Louis Loss, Associate General Counsel of the Securities and Exchange Commission, (formerly Chief Counsil of Trading and Exchange Division), who gave a course at the Yale Law School on "Regulation of Securities and Security Markets" distributed mimeographed material entitled "Cases and Materials on SEC Aspects of Corporate Finance." (Philadelphia, May 1947). On page 119 appeared the following:

> "The over-the-counter markets, in general, are the unorganized markets in which there are meetings of individual supply and demand as contrasted with the organized markets or exchanges where there are meetings of collective supply and demand. Over-the-counter transactions take place in the offices of brokers and dealers and do not involve the trading facilities of an exchange."

Quotations from other writers and texts are given to show what an "over-the-counter" market is:

"*Over the Counter.* Securities sold by brokerage

or bond houses direct to customers are sold 'over-the-counter'." The Stock Market, (1941), Dice. (Professor Business Organization, Ohio State Univ.)"

"*Over-the-Counter Market.* The over-the-counter market is an equally essential part (together with the exchanges) of the securities markets. It provides facilities for the distribution of new issues among investors and for trading in outstanding issues. The securities traded may be classed as (a) those traded exclusively over-the-counter and (b) those traded both on an exchange and over-the-counter . . ."

"*Dealers.* The market in over-the-counter securities is made by dealers within and between their offices at prices established by individual negotiation; that is, through bid and offer prices. Dealers 'create' and 'maintain' markets in the securities. A dealer creates a market for a security when he is prepared both to buy and sell that security at the prices he quotes. He maintains such a market when he continues over a period to quote the prices at which he is ready both to buy and sell. . . ." Investment Analysis, (Prime) (Professor of Finance, N. Y. Univ.) 1946.

John C. Loeser, of National Quotation Bureau, Inc., has published a book entitled, "*The Over-the-Counter Securities Market—What it is and How it Operates.*" In Chapter I, entitled, "The Over-the-Counter Market —What it is," the author states that dealers in investment securities

"create and maintain a market for securities separate and apart from those maintained on the

floors of the securities exchanges and the volume of purchases and sales of securities that they transact in this market in the course of a year is estimated in billions of dollars. Such is the importance in the nation's financial and economic organization of the financial houses—some 6,700 of them with about 2,300 branch offices throughout the country—that create and maintain what has come to be known as the over-the-counter market for securities."

At pages 6-8 the author explains the origin of the term "over-the-counter" as follows:

"ORIGIN OF THE TERM 'OVER THE COUNTER'

"The dealer in securities has played an outstanding role in the financial and economic development of the United States. There have always been commercial or financial houses of one kind or another that have acted as dealers in bonds and stocks. The first bonds issued by the Federal government and the shares in the early banks, insurance companies and other corporations were dealt in by the early merchant houses and state-chartered banks of the post-Revolution period.

"The term 'over the counter,' however, does not appear to have originated or come into general use until a century or so ago. Investors of that period were accustomed to make their purchases and sales of investment securities through the private banking houses which, as one of their regular activities, engaged in the business of buying and selling United States government, municipal and corporate bonds as dealers.

"In their interior appearance, these houses were

not unlike small commercial banks of today. There were counters such as are found in modern banking institutions and over these, investors directly bought from and sold to the houses. It was over these counters that they actually paid for and accepted delivery of the securities they bought and delivered and accepted payment for the securities they sold. Hence, purchases and sales transacted by these dealer institutions came to be known as transactions 'over the counters' to distinguish them from those effected by public auction of the 'stock and exchange boards' as exchanges were then called. The present securities houses and banks that act as dealers are the successors to the trading function of the earlier private bankers and the market which they create and maintain separate and apart from the exchanges has thus become known as the over-the-counter market.

"Fundamentally there is little essential difference in the manner in which investors of a century ago transacted business with the private bankers and those of the present do business with today's over-the-counter dealers. Just as investors bought and sold securities over the counters of the private banking houses, so today such investors as the banks, insurance companies and other institutions as well as individuals, approach the over-the-counter dealers and directly buy securities from them and sell securities to them."

This above referred to book was published in 1940 by National Quotation Bureau, Inc., with offices in New York, Chicago, and San Francisco.

In "*The Modern Corporation and Private Property,*"

by Berle and Means, an "over-the-counter market" is defined as follows (pp. 290-2):

> "Security markets are of all gradations, though the underlying idea is always the same. . . .
>
> "At the lowest end of the scale are the so-called 'private' or 'made' markets. They are maintained by a single investment banking house which constantly draws in buyers and sellers. These commonly exist in respect of some one security only, the familiar phrase being that 'the market for the security is "made" by' such and such a house. Where a security is not listed on an Exchange, it is frequently sold under some kind of promise of liquidity; the investment banking house sponsoring the issue will usually undertake this responsibility for a time at least.
>
> "The combination of a great number of such situations gives rise to what is known as an 'over the counter' market."

This book was published by The McMillan Company, New York (1933).

In "*The Security Markets*," published by Twentieth Century Fund, Inc., New York (1935), the nature of the over-the-counter markets and the manner of their operation is described as follows (pp. 263-6):

> "a. Nature of the Over the-Counter Markets.
>
> "The over-the-counter markets are private markets for securities in which dealings are not conducted on organized exchanges, or for which the organized exchanges do not at present provide the

most desirable trading facilities. There is no public meeting of supply and demand in these markets. Instead, the supply, at any given moment, must seek a corresponding demand or the demand must seek a corresponding supply. The public meeting of supply and demand on the organized exchanges is evidenced by the concentration of the brokers on the floor of the Exchange, their open bidding and offering of securities, and their knowledge, and that of the public generally, of the prices and amounts at which transactions take place. The private character of these unorganized markets is evidenced by the absence of these circumstances. A transaction in the over-the-counter markets is known only to the particular customer and dealer involved. The dealer buys a given security from one customer and sells it to another, and neither of the two customers, nor their brokers, knows of the other's transaction. There is no public record of the transaction, and no ticker or quotation service."

"c. How the Over-the-Counter Market Operates.

"Over-the-counter transactions in stock are ordinarily conducted about as follows: Dealer Blank, having an order to buy 100 shares of Third National Bank stock for a customer, may call Dealer Doe and ask him for the market in that stock. Dealer Doe replies 113-115, meaning that he will buy at 113 and sell at 115, though usually without at the time indicating the size of the market. The 2 point difference represents the profit Dealer Doe expects to make on deals in that stock, though his expectation may not be fulfilled. Dealer Blank may accept, may ask for a better price or may go to another dealer. Dealer Blank may have

several competing brokers on the wire at one time, and get the best prices of each. After purchasing the stock, Dealer Blank notifies his customer, 'I have sold to you 100 shares of Third National Bank stock.' In the case of a selling order, the same routine would be followed, except that Dealer Blank would find a purchaser for the stock and would notify the customer, 'I have bought from you 100 shares of Third National Bank stock.' In both cases Dealer Blank is a principal twice; that is, he both buys and sells for his own account. He seldom charges a commission for his services, but gets a profit from the difference between his buying and selling prices. This difference will vary according to his judgment of how good a buy he has made, how valuable a customer this particular individual or company is, how much difficulty he had in filling the order and, above all, how much the traffic will bear—that is, how big a spread can be obtained between the purchase and sale prices."

The authoritative nature of the above publication is evidenced by the fact that in H. R. Rep. No. 1383, recommending the adoption of the Securities Act of 1934, reference is twice made (pp. 10, 16) to "*The Security Markets.*"

Apparently at the time when the House report was rendered, "*The Security Markets*" had not been published but was in the course of preparation.

In "*The Securities Exchange Act of* 1934, *Analyzed and Explained,*" by Charles H. Meyer, the author in discussing Section 15 of the Act, dealing with over-the-counter markets, says (pp. 106-7):

"What constitutes an over-the-counter market:

"Not every transaction in a security off an exchange is subect to regulation under this section, but only transactions on over-the-counter markets. It is therefore important to determine what is an over-the-counter market. Such a market may be maintained by a single broker or dealer, or by a number of them. It is a market which provides facilities for *both the purchase and the sale of a security.* A broker who stands ready either to buy or to sell or to quote the price at which he will buy or sell conducts such a market. (Italics in text).

"What is not an over-the-counter market—

"The negotiation by a broker or dealer of a single sale or purchase, no matter how large, is not affected by over-the-counter regulations. Only 'markets' are regulated and not single transactions.

"Purchases and sales by individuals who are neither brokers nor dealers do not constitute an over-the-counter market. Stockholders in corporations, whether small or large, are free to acquire and dispose of their securities themselves, unfettered by Federal regulations."

This book is published by Francis Emory Fitch, Inc., Financial Publishers, 138 Pearl Street, New York. Mr. Meyer is a member of the New York bar and is the author of *"The Law of Stockbrokers and Stock Exchanges"* and *"Legal Pitfalls of the Stock Brokerage Business and How They May Be Avoided."* His writings have been referred to authoritatively by the SEC

in *In the Matter of Barrett & Company*, 9 SEC 319, 328 (1941).

To the same effect see "Manipulation of Over-the-Counter Securities Markets," 10 George Washington Law Review 639, (Footnote 2), (1942) and "Regulation of Stock Market Manipulation," 56 Yale Law Journal 509, 530 (1947).

In the Matter of Barrett N *Co.*, *supra*, the Commission said (p. 323):

> "The over-the-counter market differs from that that of the exchange market in that transactions are not reported; quotations for a particular security are published only by those dealers who are interested in the security and who make an over-the-counter market for it. Frequently, a dealer publishes two sets of quotations, an 'inside' market at which he indicates interest in buying from or selling to other dealers, and an 'outside' market, within the range of which he indicates an interest in buying from or selling to a member of the public. The 'inside' prices are published daily in quotation sheets, the largest and most important of which is circulated by National Quotation Service, Inc. The Eastern sheets are received by subscribers in New York and Boston the morning following the date of publication. The 'inside' prices published in these sheets are prices furnished by the various firms shortly after noon on the date of publication. While the practice is not invariable, 'outside' prices usually are also quoted through various media, depending upon the nature of the security. Large issues of securities that are widely held or in which there is a widespread interest are usually quoted weekly in financial pe-

riodicals and daily in the large metropolitan newspapers, whereas the smaller issues, when they are quoted, are usually included daily or weekly in newspapers of general circulation in those particular areas in which ownership of the security is concentrated.

* * * * *

"While neither 'inside' nor 'outisde' quotations are necessarily firm offers to buy and sell, and while actual bids and offers on the day following publication of such quotations may vary slightly from the quoted 'inside' or 'outside' prices, the published quotations, nevertheless, constitute the reported market held forth to the public and to dealers."

In footnote 22 of the brief of *Amicus Curiae* at pages 39 and 40 (typewritten draft) and also footnote 11, page 830 in the case of *Speed v. Trans-America Corp., supra*, are brief quotations from two writers, which, taken by themselves, would perhaps support the contention made by the Commission that an isolated sale on a doorstep is a part of the over-the-counter market. However, when the whole of the section, in which these quotations appear, is read, it becomes obvious that the writers are also discussing a market maintained by brokers and dealers off a registered exchange. So that this Court will not be misled by these partial quotations we set them forth below in full:

"First of all, what is meant by the over-the-counter market? Briefly, this market embraces

all transactions in securities not made on stock exchanges. In size and diversity of issues dealt in, it is far greater than all the nation's stock exchanges. The underwriting and distribution of new corporate issues are accomplished through the mechanism of the over-the-counter market. Today, practically all the buying and selling of government, state and municipal bonds and a maority of the transactions in corporate bonds is over the counter. Activity in preferred stocks and various specialized types of common shares and investment trust units is also largely over the counter. Only in the common stocks and perhaps the most speculative types of preferred stocks and bonds do stock exchange volume exceed those of over the counter. Although it deals in listed as well as unlisted securities, the predominant concern of the over-the-counter market is with new issues and the obtaining of capital necessary for private enterprises to develop and expand."

Fundamentals of Investment Banking, Sec. 8, p. 42 (Investment Bankers Association, of America, 1947): (Entire paragraph).

"The market for securities not listed on any regularly organized exchange. More stocks and bonds are represented by such markets than on the stock exchanges. Frequently, large blocks of bonds and stocks, represented on stock exchanges, are dealt with on such outside markets, one of the functions of the over-the-counter markets being to effectuate redistribution of securities not previously digested. For example, United States Government issues, though listed, are frequently bought and sold in large blocks over the counter. Practically all dealings in state and municipal bonds are upon over-the-counter markets, which also command almost exclusive dealings in bank,

insurance and investment trust shares as well as real estate bonds.

Over-the-counter markets in the United States, though lacking in volume and interest, actually exceed the number of listings on the organized exchanges. As of the middle of 1935, a careful estimate disclosed that quotations are available, on not less than 25,000 unlisted bonds and 30,000 unlisted stocks or fully 55,000 separate over-the-counter securities throughout the United States. By contrast, listings on registered stock exchanges totalled about 7,000, of which about 2,300 were on the New York Stock Exchange." (The Article continues in the same vein.) *Over-the-counter Market, Munn,* Encyclopedia of Banking and Finance (1037), p. 613. (Entire Paragraph and succeeding Paragraph).

APPENDIX "C"

Article Appearing in 64 Harvard Law Review 1018.

"SECURITIES ACTS—FEDERAL SECURITIES EXCHANGE ACT — FRAUDULENT PURCHASE OF NON-REGISTERED SHARES OF CLOSELY-HELD CORPORATIONS IS VIOLATION OF SECTION 10 (b).—Plaintiffs had sold their minority interest in a closely held corporation to the defendants, maority shareholders, who were also officers and directors of the corporation to the defendants, majority shareholders, who were also officers and directors of the corporation. Alleging that due to defendants' fraudulent representations made through the mails the price was less than the actual value of the shares, plaintiffs sought damages under SEC Rule X-10B-5, 17 Code Fed. Regs. Section 240.10b-5

(1949), which prohibits the use of the mails, or of other instrumentalities of interstate commerce, or of any facility of a national securities exchange, by any person, to deceive or mislead in connection with the purchase or sale of any security. Defendants moved to dismiss the complaint contending that Section 10(b) of the Securities Exchange Act 48 Stat. 891 (1934) 15 U.S.C. Section 78j (b) (1946), under which the rule was promulgated, is not applicable where, as here, the shares are not registered on a national securities exchange, nor regularly traded over the counter by dealers or brokers . *Held,* that since Section 10(b), by its terms, applies where shares are" . . . registered . . . or not so registered. . . ." the transaction was clearly within the section. Motion denied. *Robinson v. Difford,* 92 F. Supp. 145 (E. D. Pa. 1950).

"This is the first explicit judicial determination that the fraud provisions of Section 10 (b) may be invoked even though the unregistered securities were not of an issue regularly traded. See Brief for Defendant (Slavin), p. 11, *Kardon v. National Gypsum Co.,* 69 F. Supp. 512 (E.D. Pa. 1946). That Section 10 (b) was intended to afford protection against transactions involving such securities is questionable.

Section 2, declaring that security transactions are affected with a national public interest, making control and regulation necessary, mentions only transactions conducted upon exchanges and over-the-counter markets; and though no part of the legislative history refers to Section 10 (b) with particularity, the debates on other provisions of the Act seem to indicate that Congress intended only to regulate and affect dealings in registered securities and unregistered securities trad-

ed over the counter, 78 Cong. Rec. 8190 (1934). The plaintiffs, and the SEC, (Brief for SEC as Amicus Curiae, pp. 7-10) urged that the over-the-counter market embraces all transactions in unregistered securities. The terms of Rule X-10B-5 also reflects this broad interpretation. However, common business understanding, see Munn, Encyclopedia of Banking and Finance 613 (1937), discussions in Congress when enacting the statute, 78 Cong. Rec. 8190 (1934), and the provisions of Section 15, providing for the regulation of brokers and dealers trading over the counter, as originally written 48 STAT. 895 (1934), indicate that such a market does not exist unless brokers or dealers regularly deal in the issue. But cf. H. R. Rep. No. 2307, 75th Cong., 3d Sess. 2, 3, 5 (1938) (conflicting statements as to coverage intended by over-the-counter regulation of brokers and dealers under Stcion 15 as originally enacted.

"Since isolated transactions in securities of closely held corporations do not seem to be affected with a substantial national public interest, at least as determined by Congress in Section 2, it appears unlikely that Congress intended the statute to be applicable to dealings of this character, especially in view of the substantial criminal liabilities imposed for violation of the Act. And whatever doubt may remain concerning the intended scope of the Act should not necessarily be resolved in favor of the SEC's interpretation in Rule X-10B-5, since the eight-year delay before promulgation may be an indication of the Commission's doubt as to the validity of its interpretation. Cf. *FPC v. Panhandle Eastern Pipe iLne Co.*, 337 U.S. 498 (1949).

"Limiting the coverage of the Act to transactions in registered or regularly traded securities would not deprive Section 10(b)'s reference to unregistered securities of substantial meaning. Where, for example, a person who is not a broker or dealer engages in deceptive practices in connection with the purchase of a nonregistered security, which issue is regularly traded by brokers or dealers over the counter, only Section 10(b) constitutes a basis for recovery under either the Securities Act of 1933, 48 STAT. 74 (1933), 15 U.S.C. Section 77a-77aa (1946). Although a plaintiff cannot avail himself of the nation-wide service of process and liberal venue provisions of the Act, Securities Exchange Act Section 27, 48 STAT. 902 (1934), as amended 49 STAT. 1921 (1936), 15 U.S.C. Section 78aa (1946), in cases excluded by the suggested interpretation, he is not deprived of all remedies. Resort may still be had to state law, and most states impose the same obligation of fair dealing, at least on "insiders," as does the Act. e.g., "*Hotchkiss v. Fischer*, 136 Kan. 530, 16 P. (2d) 531 (1932). But cf. *Goodwin v. Agassiz*, 283 Mass. 358, 186 N. E. 659 (1933). Further, although Rule X-10B-5 literally imposes the same standard on "noninsiders" as on "insiders," it seems unlikely as a practical matter that the Federal courts will hold "noninsiders," who by definition have no ready access to confidential information, to a higher degree of responsibility than do the courts under existing state law. See Note, 59 Yale L.J. 1156 (1950)."